

# Fall 2010

## Quizzes & MCQs

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1. Diversification eliminates unique risk. But there is some risk that diversification can not eliminates. This is called as:
  1. **Market Risk**
  2. Systematic Risk
  3. Unsystematic Risk
  4. All of the given options
  
1. \_\_\_\_\_ arises due to internal factors.
  1. Hard Rationing
  2. **Soft Rationing**
  3. Single period rationing
  4. All of the given options
  
1. \_\_\_\_\_ is a technique which indicates how much a project's NPV will change in response to a given change in an input variable, other things held constant.
  1. Break Even Analysis
  2. Degree of Operating Leverage
  3. **Sensitivity analysis**
  4. Scenario analysis
  
1. Which of the following is advance tool of Project Evaluation?
  1. Net Present value NPV
  2. Internal Rate of Return IRR
  3. Pay Back Period Method
  4. **Sensitivity analysis**
  
1. In case of more than one project, the project with \_\_\_\_\_ NPV can be undertaken.
  1. Low
  2. **Higher**
  3. Moderate
  4. zero

For the statement of cash flows, which of the following is considered a cash flow item from investing activities?



- A) Cash inflow from borrowing
- B) Cash outflow to acquire fixed assets**
- C) Cash outflow to government for taxes
- D) Cash inflow from dividend income

2. Expected changes in capital expenditures and firm dividend policy during the next year are both likely to influence \_\_\_\_\_.

- A) Cash receipts of the firm
- B) Cash disbursements of the firm**
- C) Earned (receipts) from Treasury bills held by the firm
- D) Disbursements to holders of the firm's 10-year, 8% fixed rate bonds

3. The key to the accuracy of the cash budget is:

- A) The sales forecast.**
- B) The expenses forecast.
- C) The inventory control method used.
- D) The seasonality of cash flows.

4. When working capital management is discussed, \_\_\_\_\_ and \_\_\_\_\_ tend to be thought of as forms of spontaneous financing.

- A) Short-term debt, cash
- B) Accounts payable, accruals**
- C) Accounts payable, short-term debt
- D) Accruals, cash

5. Short-term financing is riskier than long-term financing because:

- A) Short-term interest rates fluctuate; long-term rates do not.
- B) Short-term debt must be refunded more frequently than long-term debt.**
- C) Short-term interest rates are usually higher than long-term interest rates.
- D) The amount of money that can be raised by short-term borrowing is much less than the amount that can be raised long-term.

6. Which of the following describes the hedging approach to financing?

A) Maturity dates of financing instruments are staggered so that they mature in a steady, predictable fashion.

**B) Each asset is offset with a financing instrument of the same approximate maturity.**

C) Each asset is offset with a put or call.

D) The firm takes out insurance to protect itself against uneven cash flows.

7. When the firm considers working capital management, the trade off between risk and return is affected by all of the following except

A) The pattern of cash borrowing needs of the firm.

B) The difference between long-term and short-term interest rates.

**C) The ratio of cash to marketable securities.**

D) The debt maturity schedule.

8. Firms with more certain cash flow patterns can operate with:

A) A higher level of accounts receivable to inventories.

B) A lower proportion of long-term to short-term debt.

**C) A lower proportion of liquid to total assets.**

D) A higher proportion of liquid to total assets.

9. An increase in the firm's receivable turnover ratio means that \_\_\_\_\_.

A) It has initiated more liberal credit terms with no increase in sales

**B) It is collecting credit sales more quickly than before**

C) Cash sales have decreased

D) Inventories have increased

10. The largest single source of short-term financing for businesses collectively is

A) Commercial paper.

**B) Trade credit.**

C) Bank loans.

D) Trade acceptances.

1. Which of the following statements is TRUE regarding Profitability Index?





- a. It ignores time value of money
  - b. It ignores return on investment**
  - c. It ignores future cash flows
  - d. It ignores the scale of investment
2. Which of the following terms refers to the process of systematic investigation of the effects on estimates or outcomes of changes in data or parameter inputs or assumptions to evaluate a capital project?
- a. Sensitivity Analysis**
  - b. Fundamental Analysis
  - c. Technical Analysis
  - d. Trend Analysis
3. Holding everything else constant, increasing fixed costs \_\_\_\_\_ the firm's break-even point.
- a. Decreases
  - b. Increases**
  - c. Increases the covariance of
  - d. Does not affect
4. A company has fixed costs of \$50,000 and variable costs per unit of output of \$8. If its sole product sells for \$18, what is the break-even quantity of output?
- a. 2,500
  - b. 1,500
  - c. 5,000**
  - d. 7,500
5. If sensitivity analysis concludes that the largest impact on profits would come from changes in the sales level, then which of the following recommendations should be considered?
- a. Fixed costs should be traded for variable costs
  - b. Variable costs should be traded for fixed costs
  - c. The project should not be undertaken
  - d. Additional marketing analysis may be beneficial before proceeding**
6. Which of the following best illustrates the problem imposed by capital rationing?
- a. Bypassing projects that have positive NPVs**
  - b. Accepting projects with the highest NPVs first
  - c. Accepting projects with the highest IRRs first
  - d. Bypassing projects that have positive IRRs
7. Which of the following may be a major reason for hard capital rationing?



- a. Dilution of earning per share (EPS)
  - b. High interest rate**
  - c. High interest expense
  - d. Company own policies
8. The percentage change in a firm's operating profit (EBIT) resulting from a 1% change in output (sales) is known as the \_\_\_\_\_.
- a. Degree of profit leverage
  - b. Degree of operating leverage**
  - c. Degree of total leverage
  - d. Degree of financial leverage
9. Which of the following is a major limitation of Linear Programming Technique of capital projects selection?
- a. Time value of money is not considered
  - b. Ignores the relative size of the Investment**
  - c. Project cash flows are ignored
  - d. Project profitability is ignored
10. Which of the following methods would be most suitable for selecting capital project(s) in case of multi-period capital rationing?
- a. Simple payback period
  - b. Linear Programming**
  - c. Discounted payback period
  - d. Multiple Internal Rate of Return
11. What is the main purpose of constructing a portfolio of financial assets?
- a. To maximize risk and minimize the return
  - b. To maximize the return and minimize the risk**
  - c. To minimize the risk and minimize the return
  - d. To minimize the return and minimize the risk
12. Suppose a stock is selling today for Rs.35 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.39.00. What is the dividend yield on the stock?
- a. 2%
  - b. 3%
  - c. 4%
  - d. 5%**



13. Which of the following measures systematic risk of a firm's common stock?

- a. CAPM
- b. Beta**
- c. MM-Model
- d. SML

14. Which of the following is known as market portfolio?

- a. A portfolio consists of all risk free securities available in the market
- b. A portfolio consists of all securities available in the market**
- c. A portfolio consists of securities of the same industry
- d. A portfolio consists of all aggressive securities available in the market

15. A market portfolio has a beta equal to:

- a. 0
- b. 1**
- c. 2
- d. 3

16. Which of the following shows the reward to risk ratio of a security A?

- a. Expected return of A ( $r_A$ ) – Risk free return / required return of A
- b. Expected return of A ( $r_A$ ) – Risk free return / Beta of A**
- c. Expected return of A ( $r_A$ ) – Beta of A / Risk free return
- d. Risk free return - Expected return of A ( $r_A$ ) / Beta of A

17. In which of the following conditions a stock is said to be overvalued?

- a. If the stock has market value less than the expected value
- b. If the stock has market value equal to the expect value
- c. If the stock has market value more than the expected value**
- d. If the stock has market value less than its intrinsic value

18. Which of the following statements applies to Dividend Growth Model?

- a. It is difficult to understand and use
- b. It do not consider risk level of a security**
- c. It is used for non-listed companies
- d. It is used for debt securities also

19. Which of the following is the principal advantage of high debt financing?

- a. Low bankruptcy costs
- b. Tax savings**
- c. Minimum financial risk
- d. Low financial leverage

20. Which of the following is a disadvantage of Capital Asset Pricing model?



- a. It consider market risk
- b. It is based on past data**
- c. It can be used for listed companies
- d. It can be used for non-listed companies

1-Which of the following is the principal advantage of high debt financing?

Select correct option:

**Tax savings**

Low bankruptcy costs

Minimum financial risk

Low financial leverage

2-Which of the following is tax deductible?

Select correct option:

Dividend on preferred shares

Dividend on common stocks

Coupon payments on bonds

**Capital gain on common stocks**

3-Which of the following describes the hedging approach to financing?

Select correct option:

Maturity dates of financing instruments are spread over a period of time so that they mature in a steady, predictable fashion

**Each asset is offset with a financing instrument of the same approximate maturity.**

Each asset is offset with a put or call option.

The firm takes out insurance to protect itself against uneven cash flows.

[http://wps.pearsoned.co.uk/wps/media/objects/1669/1709919/0273685988\\_ch08.ppt](http://wps.pearsoned.co.uk/wps/media/objects/1669/1709919/0273685988_ch08.ppt)

4-Which one of the following transactions take place in a primary financial market?

Select correct option:

**Initial Public Offering**

Buying Mutual Funds Certificates

Selling old shares

Buying Bonds issued in previous year

5-Holmes Aircraft recently announced an increase in its net income, yet its net cash flow declined relative to last year. Which of the following could explain this performance?



Select correct option:

The company's taxes increased.

**The company's depreciation expense declined.**

The company's operating income declined.

All of the given statements are correct

6-Which of the following changes will increase the Net Present Value (NPV ) of a project?

Select correct option:

**A decrease in the discount rate**

A decrease in the size of the cash inflows

An increase in the initial cost of the project

A decrease in the number of cash inflows

7-Which of the following technique of stock evaluation considers quantitative factors as well as qualitative factors for valuation?

Select correct option:

Technical Analysis

**Fundamental Analysis**

Constant Growth Model

No Growth Model

8-The formula for the break-even quantity of output (QBE), given the price per unit (P), fixed costs (FC), and variable cost per unit (V), is:

Select correct option:

$QBE = (P - V) / FC$ .

$QBE = (P / FC) - V$ .

**$QBE = (FC / P) - V$ .**

$QBE = FC / (P - V)$ .

9-With respect to Cash flow statement, "Decrease in current liability" would be considered as a:

Select correct option:

**Cash outflow**

Cash inflow

Sometimes as cash inflow and sometimes as cash outflow

Cannot be determined

10-Which of the following statement is CORRECT regarding residual dividend policy?

Select correct option:

Shareholders are paid dividend from capital





**Dividend are paid after meeting all the financial needs of the firm**

The management sets a fixed payout ratio

Shareholders are paid fixed dividend every year

11-Which of the following focuses on long-term decision-making regarding the acquisition of projects?

Select correct option:

Working Capital Management

**Capital Budgeting**

Cash Budgeting

None of the given options

12-Which of the following is determined by variance of an investment's returns?

Select correct option:

**Volatility of the rates of return.**

Probability of a negative return.

Historic return over long periods.

Average value of the investment

1. A firm collects 70 percent of its credit sales in 30 days, 20 percent in 60 days, and 10 percent in 90 days. The average collection period is:

A) 33 days.

B) 56 days.

C) 47 days.

**D) 42 days.**

2. A more aggressive financing policy by a firm would lead to \_\_\_\_\_ profitability and \_\_\_\_\_ risk.

A) higher, lower

**B) higher, higher**

C) lower, higher

D) lower, lower

3. Financial data for three firms is presented below. Each differs only with respect to philosophy on an aggressive vs. a conservative approach to current asset management.

FIRM A

FIRM B

FIRM C



Sales	\$2,000,000	\$2,000,000	\$2,000,000
EBIT	200,000	200,000	200,000
Current Assets	600,000	500,000	400,000
Fixed Assets	500,000	500,000	500,000
Total Assets	1,100,000	1,000,000	900,000

The firm with the least aggressive philosophy has an asset turnover of

- A) 3.33-to-1.
- B) 2.22-to-1.
- C) 5.00-to-1.
- D) 1.82-to-1.**

4. Temporary working capital

- A) Varies with seasonal requirements.**
- B) is the constant component of working capital.
- C) excludes inventories.
- D) should be financed with bonds or common stock.

5. Which of the following would be consistent with a more aggressive (i.e., a high risk-profitability) approach to financing working capital?

- A) Financing permanent inventory buildup with long-term funds.
- B) Financing seasonal needs with short-term funds.
- C) Financing short-term needs with short-term funds.
- D) Financing some long-term needs with short-term funds**

6. When the firm considers working capital management, the trade off between

risk and return is affected by all of the following except

- A) The pattern of cash borrowing needs of the firm.
- B) The difference between long-term and short-term interest rates.
- C) The ratio of cash to marketable securities.**
- D) The debt maturity schedule.

7. A good cash management system involves properly managing

- A) Collections, disbursements, cash balances, and capital investment.
- B) Collections, disbursements, cash balances, and marketable securities investment.**
- C) Only collections, disbursements, and cash balances.
- D) Only collections and disbursements.

8. The International Co. is holding cash as a buffer in case of an unexpected

need with operations. This is an example of the \_\_\_\_\_ motive for holding cash.

- A) **Precautionary**
- B) Speculative
- C) Transactions
- D) Capital needs

9. A competing firm has made a hostile offer for your corporation. You have invited a second firm to make a friendly counter-bid to thwart the unwelcome hostile offer from the original bidding firm. The second firm is known as a (an) \_\_\_\_\_.

- A) **White knight**
- B) Entrenchment firm
- C) Pure-play firm
- D) Counter-offer firm

10. A leveraged buyout

- A) **is an ownership transfer financed largely by debt.**
- B) is facilitated by rising interest rates.
- C) usually involves a labor-intensive business.
- D) results in a publicly held corporation.

1. A firm wants to acquire another firm by purchasing its assets. Which of the following method could the firm use to evaluate the financial aspects of this deal?

- a. **Breakup value method**
- b. Dividend valuation method
- c. Present value method
- d. Price earning ratio method

2. Which of the following is a major limitation of an income based method of share valuation?

- a. **Future growth assumptions**
- b. Estimation of future cash flows
- c. Future cash flow valuation
- d. Future cash flow discounting

3. All of the following are related to an income based method of shares valuation EXCEPT?



- a. Future cash flows
  - b. Future growth
  - c. Discount rate
  - d. **Book values**
4. Which of the following statement applies to employees' buyout?
- a. Employees are promoted to the higher positions
  - b. Employees are given more responsibilities
  - c. **Employees buy majority shares in the firm**
  - d. Employees buy shares of a competing firm
5. Management of a firm prefers buyout because of the following reason?
- a. The company is selling at below the market price
  - b. The company has good future prospects
  - c. Company offers good product
  - d. **Company's management could change**
6. Which of the following could be a major disadvantage of an LBO?
- a. **The acquired firm would have a high interest expense**
  - b. The acquired firm would have a high operating cost
  - c. The acquired firm would have a high manufacturing cost
  - d. The acquired firm would have a high operating risk
7. In which of the following acquisition strategy, a purchaser has complete knowledge of the acquiring firm?
- a. Management Buy-In
  - b. **Management buyout**
  - c. Consolidation
  - d. Amalgamation
8. Which of the following would be an example of an MBO?
- a. **Management of a firm-A purchases majority shares from the shareholders**
  - b. Management of a firm-A acquires majority shares in another firm-B
  - c. Management sale out some assets of the firm
  - d. Management buy some new plants and machinery
9. All of the following could be an outcome of financial distress of a firm EXCEPT?

- a. Employees are leaving the firm
- b. Suppliers refuse to supply on credit
- c. Banks do not provide loans
- d. **Financial markets become instable**

10. Choose the correct statement?

- a. The price at which a FX dealer will sell a variable currency is called offer price
- b. The price at which an FX dealer will buy the base currency is called bid price
- c. **The price at which an FX dealer will sell a variable currency is called bid price**
- d. The price at which an FX dealer will sell a base currency is called bid price

1. According to the Capital Asset Pricing Model (CAPM), which of the following represent the amount of compensation the investor needs for taking on additional risk?

- a.  **$\beta (r_M - r_F)$**
- b.  $\beta (r_M + r_F)$
- c.  $r_F$
- d.  $(r_M - r_F)$

2. Which of the following is measured by Beta ( $\beta$ ) of a security.

- a. **Systematic risk of the security**
- b. Unsystematic risk of the security
- c. Market risk premium of the security
- d. Expected return of the security

3. If the risk-free rate is 3%, the beta (risk measure) of a stock is 2 and the expected market return over the period is 10%, according to the CAPM the expected return of the stock would be

- a. **17%**
- b. 20%
- c. 29%
- d. 15%

4. Which of the following statement is correct with respect to a company heavily financed by debt?

- a. **The company has a higher level of risk**
- b. The company has high cost of capital





- c. The company is unable to meet its debt obligations
  - d. The company can not issue common shares
5. Which of the following represents the compensation that the market demands in exchange for owning the asset and bearing the risk of ownership?
- a. Market risk Premium
  - b. A firm's Cost of debt
  - c. Risk free rate of return
  - d. A firm's Cost of equity**
6. Which of the following will decrease the cost of debt?
- a. A decrease in the tax rate
  - b. A decrease in Current Liability
  - c. An increase in the tax rate**
  - d. An increase in Current Assets
7. The purpose of Weighted Average Cost of Capital is to measure:
- a. The cost of debt
  - b. The cost of equity
  - c. The cost of capital**
  - d. The cost of sales
8. A company's after-tax cost of debt is 3%, if the company's marginal tax rate were 40% what would be its before-tax cost of debt?
- a. 5%**
  - b. 3%
  - c. 1.80%
  - d. 2%
9. Which of the following is the appropriate discount rate to use for cash flows with risk that is similar to that of the overall firm?
- a. Cost of Debt
  - b. Cost of Equity
  - c. Weighted Average Cost of Capital**
  - d. Cost of Retained earning

10. Which of the following measure compares the risk of an unlevered company to the risk of the market?

- a. **Ungeared Beta**
- b. Geared Beta
- c. Portfolio Beta
- d. Stock Beta

In which of the following dividend policy, the amount of dividend is relatively fixed?

**Constant payout ratio policy**

Hybrid Dividend policy

Residual Dividend policy

Stable dividend policy

The present value of Rs.5,000 received at the end of 5 years, discounted at 10 percent, is closest to:

**Rs.3,105.**

Rs.823.

Rs.620.

Rs.3,403.

Which of the following is the correct definition for "spread" in cash management?

The difference between optimal cash balance and Nominal Cash balance

The difference between opening cash balance and ending cash balance.

**The difference between upper limit and lower limit of cash balances**

The difference between optimal cash balance and ending cash balance

Which of the following method can be used to forecast the sales of a firm?

Price – earning ratio



Cash flow estimation  
**Fundamental Analysis**  
Regression Analysis

Suppose a stock is selling today for Rs.35 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.39.00. What is the dividend yield on the stock?

Select correct option:

- 2%
- 3%
- 4%
- 5%**

Which of following are two most likely motives in explaining why firms hold cash?

Speculative motive and the precautionary motive

**Transactions motive and the speculative motive.**

Precautionary motive and the managerial entrenchment motive.

Transactions motive and the precautionary motive.

Suppose you wish to set aside Rs.2,000 at the beginning of each of the next 10 years (the first Rs.2,000 deposit would be made now) in an account paying 12 percent compounded annually. Approximately how much will you accumulate at the end of 10 years?

Select correct option:

- Rs.22,863
- Rs.35,097**
- Rs.39,310
- Rs.25,151

Which of the following condition if exist will make the diversification more effective?

Securities contained in a portfolio are positively correlated  
**Securities contained in a portfolio are negatively correlated**  
Securities contained in a portfolio have high market values  
Securities contained in a portfolio have low market values

Which of the following methods would be most suitable for selecting capital project (s) in case of multi-period capital rationing?

Simple payback period  
Discounted payback period  
**Multiple Internal Rate of Return**  
Linear Programming

Which of the following bonds will have the greatest percentage increase in value if all interest rates decrease by 1 percent?

20-year, zero coupon bond.  
10-year, zero coupon bond.  
**20-year, 10 percent coupon bond**  
20-year, 5 percent coupon bond.

Please choose one Which of the following is TRUE regarding optimal capital structure?

- ▶ **An optimal capital structure refers to the mix of debt and equity level where the firm has minimum cost of capital**
- ▶ An optimal capital structure refers to the mix of debt and equity level where the firm has minimum financial leverage
- ▶ An optimal capital structure refers to the mix of debt and equity level where the firm has maximum cost of capital
- ▶ An optimal capital structure refers to the mix of debt and equity level where the firm has high financial leverage

Which of the following statement is true?

WACC of a levered firm is greater than that of an un-levered firm  
WACC of a levered firm is lesser than that of an un-levered firm  
**WACC of a levered firm is equal to that of an un-levered firm**  
An Un-levered firm has zero WACC.

Which of the following is a measure of risk of an asset?

Weighted average

**Standard deviation**

Probability distribution

Geometric mean

Which of the following would NOT improve the current ratio?

**Borrow short term to finance additional fixed assets.**

Issue long-term debt to buy inventory

Sell common stock to reduce current liabilities.

Sell fixed assets to reduce accounts payable.

Since capital budgeting uses cash flows instead of accounting flows, the financial manager must add back \_\_\_\_\_ to the analysis.

The cost of fixed assets

The cost of accounts payable

Investments

**Depreciation**

A dividend payment made in the form of additional shares, rather than a cash payout is known as:

**Stock Dividend**

Cum Dividend

Ex Dividend

Extra Dividend

In inventory management, the storage cost of inventory is considered as:

**Carrying cost** (DOUBTED)

Reorder cost

Stock out cost

Safety cost





Question # 11 of 15 ( Start time: 06:13:11 PM ) Total Marks: 1

All of the following factors must be considered, while making short-term investment EXCEPT:

- Liquidity
- Safety**
- Profitability
- Inventory

According to the Miller Orr Model, upper limit for cash balance is equal to:

- Lower limit + Spread**
- Spread - Lower limit
- Optimal limit + Lower limit
- Lower limit - Spread

(zh,www.Expertss.net)

Which of the following firm may be considered as a pure play in the beverages industry in Pakistan?

- Coca Cola**
- Pepsi
- Shezan
- All of the given options

Suppose you have a 2-stocks portfolio, which consists of Stock A and Stock B. If stock A has a beta value of 1.8 and stock B has a beta value of 0.68, and your investment in stock A and stocks B is equal, then the beta of this 2-stock portfolio would be equal to:

Select correct option:

- 1.20
- 1.24**
- 1.30
- 1.45

A Pure Play method of selecting a discount rate is most suitable in which of the following situations?

**When the intended investment project belongs to industry other than the firms operating in**

When the intended investment project has a conventional stream of cash flows

When the intended investment project has a Non-conventional stream of cash flows

When the intended investment project is a replacement project

Which one of the following statements describes the relationship between Interest rates and bond prices?

Move in the same direction.

**Move in opposite directions**

Sometimes move in the same direction, sometimes in opposite directions

Have no relationship with each other (i.e., they are independent).

The formula for the break-even quantity of output (QBE), given the price per unit (P), fixed costs (FC), and variable cost per unit (V), is:

$$QBE = (P - V)/FC.$$

$$QBE = (P/FC) - V.$$

$$QBE = (FC/P) - V.$$

$$QBE = FC / (P - V).$$

Which one of the following statements best describes the intrinsic value of a stock?

Intrinsic value of a stock is the future value of all expected future dividends, discounted at the dividend growth rate.

Intrinsic value of a stock is the present value of all expected future dividends, discounted at the dividend growth rate.

Intrinsic value of a stock is the future value of all expected future dividends, discounted at the investor's required return.

Intrinsic value of a stock is the present value of all expected future dividends, discounted at the investor's required return.

A risk free asset has a Beta value equal to:

- 0
- 1
- 2
- 3

Which of the following is the average time period between buying inventory and receiving cash proceeds from its eventual sale?

**Operating Cycle**

Cash Cycle

Inventory period

Inventory Turnover

Spread variation does NOT depend on which of the following factors?

Variance of cash flows

**Transaction cost** (not sure)

Interest rate

Expected cash flow

You have calculated that the required rate of return on a particular common stock is less than the expected rate of return. Therefore, you would conclude:

Select correct option:

**That the stock is more risky than the market portfolio.** Page 57

That an investor should buy the stock.

That the stock has a high dividend payout ratio.

That an investor should sell the stock.

If the Internal Rates of Return of two, mutually exclusive options are both greater than the cost of capital, which option should be selected under the Internal Rate of Return method?

Select correct option:

**The one with the largest Internal Rate of Return.**

The one with the smallest Internal Rate of Return.

The one with the highest Net Present Value at the firm's cost of capital.

None of the given options

The decision rule for net present value is to:

Select correct option:

Accept all projects with cash inflows exceeding initial cost.

Reject all projects with rates of return exceeding the opportunity cost of capital.

**Accept all projects with positive net present values.**

Reject all projects lasting longer than 10 years.

Which of the following is determined by variance of an investment's returns?

Select correct option:

**Volatility of the rates of return.**

Probability of a negative return.

Historic return over long periods.

Average value of the investment

If you deposit \$12,000 per year for 16 years (each deposit is made at the beginning of each year) in an account that pays an annual interest rate of 15%, what will your account be worth at the end of 16 years?

Select correct option:

\$82,168.44

\$71,450.82

\$768,901.12

**\$668,609.67**

Virgo Airlines will pay Rs.4.00 dividend next year on its common stock, which is currently selling at Rs.100 per share. What is the market's required return on this investment if the dividend is expected to grow at 5% forever?

Select correct option:

4 percent.

5 percent.

7 percent.

**9 percent.**

Which of the following shows the reward to risk ratio of a security A ?

Select correct option:

**Expected return of A ( $r_A$ ) - Risk free return / Beta of A**

Expected return of A ( $r_A$ ) - Risk free return / required return of A

Expected return of A ( $r_A$ ) - Beta of A / Risk free return  
Risk free return - Expected return of A ( $r_A$ ) / Beta of A

If two projects are independent, that means that \_\_\_\_\_.

Select correct option:

Selection of one precludes selection of the other.

**You should analyze the projects independently.**

Both the given options may apply

None of the given options

When the firm considers working capital management, the trade off between risk and return is NOT affected by which of the following?

The pattern of cash borrowing needs of the firm.

The difference between long-term and short-term interest rates.

**The ratio of cash to marketable securities.**

The debt maturity schedule.

If you invest Rs.400 today in a savings account paying 8 percent interest per year, how much will you have in the account at the end of three years if the interest is compounded annually?

Select correct option:

Rs.325

Rs.1,299

Rs.504

**Rs.609**

The decision rule for net present value is to:

Select correct option:

Accept all projects with cash inflows exceeding initial cost.

Reject all projects with rates of return exceeding the opportunity cost of capital.

**Accept all projects with positive net present values.**

Reject all projects lasting longer than 10 years.

A dividend payment made in the form of additional shares, rather than a cash payout is known as:



Select correct option:

**Stock Dividend**

Cum Dividend

Ex Dividend

Extra Dividend

Which of the following describes the hedging approach to financing?

Select correct option:

Maturity dates of financing instruments are spread over a period of time so that they mature in a steady, predictable fashion

Each asset is offset with a financing instrument of the same approximate maturity.

**Each asset is offset with a put or call option.**

The firm takes out insurance to protect itself against uneven cash flows.

Suppose that market now requires an 8 percent return for a bond that was issued some years ago with a 10 percent coupon. This bond will currently be priced:

Select correct option:

At a premium over face value.

At par value.

**At a discount from face value.**

At face value.

In the formula  $r_E = (D_1/P_0) + g$ , what does the symbol "g" represent?

The expected price appreciation yield from a common stock.

**The expected dividend yield from a common stock.**

The dividend yield from a preferred stock.

The interest payment from a bond.

Which of the following focuses on long-term decision-making regarding the acquisition of projects?

Working Capital Management

**Capital Budgeting**

Cash Budgeting

None of the given options

Which one of the following transactions take place in a primary financial market?

**Initial Public Offering**

Buying Mutual Funds Certificates

Selling old shares

Buying Bonds issued in previous year

Which of the following factor determines the financial viability of a project?

Future Profits

**Future Cash flows (not sure)**

Sunk Cost

None of the given option

Which of the following is the Dividend Payout ratio for a common stock?

Select correct option:

Dividend per share: Market value per share

Earning per share: Intrinsic value per share

**Dividend per share: Earning per share (not sure)**

Market value per share: intrinsic value per share

Which of the following best define the term 'Capital Structure'?

Select correct option:

**The proportion of debt and equity capital used by a firm**

The proportion of long-term liabilities used by a firm

The proportion of equity used by a firm

The proportion of short-term bank loan used by a firm

Holding everything else constant, increasing fixed costs \_\_\_\_\_ the firm's break-even point.

Select correct option:

Decreases

Increases the covariance of

**Increases**

Does not affect

Which one of the following statements is TRUE regarding future value of a single sum?

Increase if the interest rate increases.

Remains unchanged if the interest rate changes

Decrease if the interest rate increases

**All of the given options are correct (not sure)**

1. When calculating a project's annual cash flows, which of the following is not directly included?

A) The reduction in taxes attributable to sale of an asset for less than its book value

B) The tax incurred when the trade-in value of the old asset exceeds its book value

C) The reduction in taxes attributable to depreciation charges

**D) Depreciation expense**

2. The basic characteristics of relevant project flows include all of the following except

A) After-tax flows.

B) Cash flows.

C) Incremental flows.

**D) Financing flows.**

3. Project GROW will require \$250,000 to purchase new machinery. Capitalized expenditures total \$40,000. The new machine will require that the firm purchase some additional inventory which will result in an increase in net working capital of \$50,000. What is the initial cash outflow?

A) \$300,000

B) \$350,000

C) \$270,000

**D) None of the above are correct.**

4 In analyzing a long-term investment proposal,

**A) Include opportunity costs.**

B) Include before-tax interest payments.

C) Include after-tax interest payments.

D) Include sunk costs.

5. The Pink Pussycat Lounge is considering replacing its lighting system. The new lights will cost \$16,000 and can be installed for \$2,500. The old light fixtures were depreciated to zero but can be sold to Secondhand Sam for \$1,000. If the Pink Pussycat has a 35 percent tax rate, the initial cash outflow for the new lighting system is

A) \$18,500.

B) \$16,000.

C) \$17,500.

**D) \$17,850.**

6. A company is considering a project costing \$50,000. The hurdle rate is 9 percent and the project is expected to yield an ordinary annuity for 10 years. The annual annuity must be at least \_\_\_\_\_ for the project to be accepted.

A) \$9,231

B) \$8,321

C) \$8,667

**D) \$7,791**

7. Your firm is considering two mutually exclusive projects, code-named A and B, that would each require an initial cash outflow of \$10,000. They would generate the following incremental, after-tax, operating cash flows:

	Project A	Project B
Year 1	\$5,000	\$3,000
Year 2	4,000	4,000
Year 3	3,000	6,000

If the firm's required rate of return is 14 percent, which would you select?

**A) Neither project because neither adds value to the firm.**

B) Project A because it has the higher net present value.

C) Project B because it has the higher internal rate of return.

D) Project A because it has the shorter payback period.

8. A proposed investment project requires an initial cash outflow of \$82,650 and has an economic life of three years, with no salvage value. It is expected to generate before tax cash flows of \$45,000 for each of the three years. The firm's tax

rate is 30 percent. Which of the following is closest to the project's internal rate of return?

- A) 30 percent
- B) 7 percent**
- C) 40 percent
- D) 12 percent

9. The initial cost of a conventional project is \$14,000. The present value of the project's cash inflows, discounted at 12 percent, is \$12,500. The internal rate of return is

- A) Less than 12 percent.**
- B) Greater than 12 percent.
- C) Equal to 12 percent.
- D) Cannot tell without additional information

10. Hi Lighter, Inc., is considering a project with an initial investment of \$25,000 that generates cash-inflows of \$10,000 per year for 8 years starting today. What is the net present value of this project if the firm requires a 15% rate of return on this project? (Choose the nearest figure.)

- A) \$22,854
- B) \$19,873**
- C) \$1,152
- D) \$55,000

The employment of fixed costs associated with the actual production of goods or services is known as:

- Financial leverage
- Volume discounting
- Operating leverage**
- Covariance

Which of the following is a planning tool?

- A budget**
- A balance sheet
- An income statement
- A Cash flow statement

Which of the following would lower a firm's operating break-even point?

- An increase in the cost of goods sold
- An increase in selling price**
- An increase in wages paid to employees
- An increase in total sales

Suppose you have a 2-stocks portfolio, which consists of Stock A and Stock B. If stock A has a beta value of 1.8 and stock B has a beta value of 0.68, and your investment in stock A and stocks B is equal, then the beta of this 2-stock portfolio would be equal to:

Select correct option:

- 1.20
- 1.24**
- 1.30
- 1.45

Which of the following is a disadvantage of Capital Asset Pricing model?

- It consider market risk
- It can be used for listed companies
- It can be used for Non-listed companies
- It is based on Past data**

Which of the following statements applies to Dividend Growth Model?

- It is difficult to understand and use
- It is used for non-listed companies
- It is used for debt securities also
- It do not consider risk level of a security**

Which of the following changes will occur if a bond's yield-to-maturity increases, keeping other things equal?

- Its price will rise

Its price will remain unchanged

**Its price will fall.**

Can not be determined

A company has fixed costs of \$50,000 and variable costs per unit of output of \$8. If its sole product sells for \$18, what is the break-even quantity of output?

Select correct option:

2,500

**5,000**

1,500

7,500

REF:  $BEQ = FC / P - VC$

$= 50000 / 18 - 8$

$= 50000 / 10 = 5000$

Which of the following is included in the cost of capital of a firm?

Cost of sales

Depreciation cost

Depletion cost

**Cost of retained earnings**

Holmes Aircraft recently announced an increase in its net income, yet its net cash flow declined relative to last year. Which of the following could explain this performance?

The company's taxes increased.

**The company's depreciation expense declined.**

The company's operating income declined.

All of the given statements are correct.

A market portfolio has a beta equal to:

0





1  
2  
3

A Levered firm has a lower weighted average cost of capital as compare to an Un-levered firm because of:

**Interest tax shield**

Low level of financial risk  
Low level of business risk  
Low level of systematic risk

A dividend payment made in the form of additional shares, rather than a cash payout is known as:

**Stock Dividend**

Cum Dividend  
Ex Dividend  
Extra Dividend

Which of the following method can be used to forecast the sales of a firm?

Price – earning ratio  
Cash flow estimation  
**Fundamental Analysis**      **not sure**  
Regression Analysis

Dividend discount Model states that today's price of a stock is equal to:

**The Present Value of all future dividends of the stock**      **page 115**

The Present Value of the face value of the stock  
The Present Value of the Sales price of the stock  
The Present Value of the book value of the stock

The decision rule for net present value is to:

Accept all projects with cash inflows exceeding initial cost.

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Reject all projects with rates of return exceeding the opportunity cost of capital.

**Accept all projects with positive net present values.**

Reject all projects lasting longer than 10 years.

Which of the following capital budgeting technique ignores profitability and time value of money?

Net Present Value

Internal Rate of Return

Discounted Pay Back period

**Simple Pay Back Period**

Since capital budgeting uses cash flows instead of accounting flows, the financial manager must add back \_\_\_\_\_ to the analysis.

The cost of fixed assets

The cost of accounts payable

Investments

**Depreciation**

In the formula  $r_E = (D_1/P_0) + g$ , what does the symbol "g" represent?

The expected price appreciation yield from a common stock.

**The expected dividend yield from a common stock.**

The dividend yield from a preferred stock.

The interest payment from a bond.

Which of the following is an objective of an optimal capital structure?

Select correct option:

To minimize the cost of capital

To minimize cost of equity

**To minimize cost of debt**      **not sure**

To minimize cost of sales

If sensitivity analysis concludes that the largest impact on profits would come from changes in the sales level, then which of the following recommendations should be considered?

Fixed costs should be traded for variable costs

Variable costs should be traded for fixed costs.

The project should not be undertaken.

**Additional marketing analysis may be beneficial before proceeding.**

Suppose you wish to set aside Rs.2,000 at the end of each of the next 10 years in an account paying 12 percent compounded annually. You accumulate at the end of 10 years an amount closest to:

Select correct option:

Rs.22,456

**Rs.35,098**

Rs.28,324.

Rs.20,324

Which of the following investment criteria does not take the time value of money into consideration?

**Simple payback method**      page 35

Net present value

Profitability index

Internal rate of return for borrowing projects

WWhich of the following would be consistent with a more aggressive (i.e., a high risk profitability) approach to financing working capital?

Financing permanent inventory buildup with long-term funds.

**Financing seasonal needs with short-term funds.**

Financing short-term needs with short-term funds.

Financing some long-term needs with short-term funds

If a creditor wanted to know if a potential customer paid its bills on time, the creditor could look at the potential customer's:



Current ratio.

Acid ratio.

**Average age of accounts payable.**

Average age of accounts receivable

Which of the following best illustrates the problem imposed by capital rationing?

Select correct option:

**Accepting projects with the highest NPVs first**

Accepting projects with the highest IRRs first

Bypassing projects that have positive NPVs

Bypassing projects that have positive IRRs

Present value of Rs.5, 000 received at the end of 5 years, discounted at 10 percent, is closest to:

**Rs.3, 105.**

Rs.823.

Rs.620.

Rs.3, 403.

Which of the following statement best describe the term Market Correction?

**Market Correction refers to the situation where equilibrium of supply & demand of shares occurs in the market**

Market correction occurs when shares' intrinsic values becomes equal to face values

Market Correction occurs when there is a boom in the economy

Market Correction occurs when inflation rate is above the market interest rate

Which of the following is the average time period between buying inventory and receiving cash proceeds from its eventual sale?

**Operating Cycle**

Cash Cycle

Inventory period  
Inventory Turnover

## **Operating cycle**

Average time period between buying inventory and receiving cash proceeds from its eventual sale. It is determined by adding the number of days inventory is held and the collection period for accounts receivable.

current assets of company exceed its current liabilities, then the company will have:

## **A positive net working capital**

A negative working capital  
A net working capital of less than zero  
A net working capital equal to zero

Which one of the following is a major limitation of Linear Programming Technique of capital projects selection?

## **Ignores the relative size of the Investment**

Time value of money is not considered  
Project cash flows are ignored  
Project profitability is ignored

Which of the following is tax deductible?  
Select correct option:

Dividend on preferred shares  
Dividend on common stocks  
Coupon payments on bonds  
**Capital gain on common stocks**

Which of the following focuses on long-term decision-making regarding the acquisition of projects?  
Select correct option:

Working Capital Management  
**Capital Budgeting**



Cash Budgeting  
None of the given options

Question No: 1 ( Marks: 1 ) - Please choose one

Which of the following statements is TRUE regarding Profitability Index?

- ▶ It ignores time value of money
- ▶ It ignores future cash flows
- ▶ **It ignores the scale of investment**
- ▶ It ignores return on investment

Question No: 2 ( Marks: 1 ) - Please choose one

Which of the following is a tool that identifies the strengths, weaknesses, opportunities and threats of an organization?

- ▶ **SWOT Analysis**
- ▶ Trend Analysis
- ▶ Fundamental Analysis
- ▶ Technical Analysis

Question No: 3 ( Marks: 1 ) - Please choose one

Which of the following statements applies to intrinsic value of a security?

- ▶ **Intrinsic value of a security always exceeds its book value.**
- ▶ Intrinsic value of a security rises when the liquidation value falls.
- ▶ Intrinsic value of a security is the price around which its market value should closely fluctuate.
- ▶ Intrinsic value of a security is its closing market value when it is actively traded.

**Intrinsic Value (also known as fundamental value) refers to the actual value of a security based on an underlying perception of its true value due to both tangible and intangible factors. The value may defer from the current market value. As a result, value investors use an array of analytical techniques to estimate the value of the security in the hope finding investments where the true value of the investment exceeds its current market value. It can be calculated by summing the future income generated by the assets, and discounting it to the present value.**

Question No: 4 ( Marks: 1 ) - Please choose one

A Company's common stock is currently selling at Rs.3.00 per share, its quarterly dividend is Rs.0.07, and the stock is expected to rise to Rs.3.30 in a year. What is its expected rate of return?

- ▶ 9.3%
- ▶ 19.3%
- ▶ **10.0%**
- ▶ 11.0%

Question No: 5 ( Marks: 1 ) - Please choose one

For a firm with a Degree of Operating Leverage of 3.5, an increase in sales of 6% will:

- ▶ Increase pre-tax profits by 3.5%
- ▶ Decrease pre-tax profits by 3.5%.
- ▶ **Increase pre-tax profits by 21.0%.**
- ▶ Increase pre-tax profits by 1.71%.

Question No: 6 ( Marks: 1 ) - Please choose one

Which of the following best illustrates the problem imposed by capital rationing?

- ▶ **Accepting projects with the highest NPVs first**
- ▶ Accepting projects with the highest IRRs first
- ▶ By passing projects that have positive NPVs
- ▶ Bypassing projects that have positive IRRs

Capital Rationing occurs when a company has more amounts of capital budgeting projects with positive net present values than it has money to invest in them.

Therefore, some projects that should be accepted are excluded because financial capital is limited.

Question No: 7 ( Marks: 1 ) - Please choose one

A project would be financially feasible in which of the following situations?

- ▶ If Internal Rate of Return of a project is greater than zero
- ▶ If Net Present Value of a project is less than zero
- ▶ If the project has Profitability Index less than one
- ▶ **If the project has Profitability Index greater than one**

The PI would be larger than 1 for positive NPV projects and less than 1 for negative NPV projects.

Question No: 8 ( Marks: 1 ) - Please choose one

Suppose a stock is selling today for Rs.35 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.39.00. What is the dividend yield on this stock?

- ▶ 2%
- ▶ 3%
- ▶ 4%
- ▶ **5%**

**Dividend yield = Annual dividends per share / price per share**

**= 2 / 35**

**= 0.057 = 5%**

Question No: 9 ( Marks: 1 ) - Please choose one



Which of the following is considered as a risk free financial asset?

- ▶ **Government T-bills**
- ▶ Junk bonds
- ▶ Preferred stock
- ▶ Secured bonds

Question No: 10 ( Marks: 1 ) - Please choose one

Which of the following is a necessary condition for issuing shares through Initial Public Offerings (IPO's)?

- ▶ The firm must have a stable dividend policy
- ▶ The firm must have a low cost of capital
- ▶ The firm must have a low level of debt
- ▶ **The firm must be listed on the stock exchange**

Question No: 11 ( Marks: 1 ) - Please choose one

Which one of the following statements applies to Dividend Growth Model?

- ▶ It is difficult to understand and use
- ▶ It is used for non-listed companies
- ▶ It is used for debt securities also
- ▶ **It do not consider risk level of a security**

Question No: 12 ( Marks: 1 ) - Please choose one

Which of the following *best* define the term 'Capital Structure'?

- ▶ The proportion of equity used by a firm
- ▶ **The proportion of debt and equity capital used by a firm**
- ▶ The proportion of long-term liabilities used by a firm
- ▶ The proportion of short-term bank loan used by a firm

In finance, capital structure refers to the way a corporation finances its assets through some combination of equity, debt, or hybrid securities. A firm's capital structure is then the composition or 'structure' of its liabilities.

Question No: 13 ( Marks: 1 ) - Please choose one

A Pure Play method of selecting a discount rate is most suitable in which of the following situations?

- ▶ When the intended investment project has a Non-conventional stream of cash flows
- ▶ When the intended investment project is a replacement project
- ▶ **When the intended investment project belongs to industry other than the firms operating in**
- ▶ When the intended investment project has a conventional stream of cash flows



Question No: 14 ( Marks: 1 ) - Please choose one

Which of the following is a dividend that is paid in the form of additional shares, rather than a cash payout?

- ▶ **Stock Dividend**
- ▶ Cum Dividend
- ▶ Ex Dividend
- ▶ Extra Dividend

Question No: 15 ( Marks: 1 ) - Please choose one

Which of the following is a proposition of Miller and Modigliani theory of Capital structure?

- ▶ **Value of a firm is independent of its capital structure**
- ▶ Value of a firm is independent of its level of debt
- ▶ Value of a firm is dependent of its cost of capital
- ▶ Value of a firm is independent on its level of equity finances

Question No: 16 ( Marks: 1 ) - Please choose one

Which of the following transactions would occur in a primary financial market?

- ▶ **Initial public offering**
- ▶ Buying mutual funds certificates
- ▶ Selling old shares
- ▶ Buying bonds issued in previous year

Question No: 17 ( Marks: 1 ) - Please choose one

What will be the effect of reduction in the cost of capital on the accounting break-even level of revenues?

- ▶ It raises the break-even level.
- ▶ It reduces the break-even level.
- ▶ **It has no effect on the break-even level.**
- ▶ This cannot be determined without knowing the length of the investment horizon.

Question No: 18 ( Marks: 1 ) - Please choose one

Which of the following statements is TRUE regarding Balance Sheet of a firm?

- ▶ It reports how much of the firm's earnings were retained in the business rather than paid out in dividends.
- ▶ It reports the impact of a firm's operating, investing, and financing activities on cash flows over an accounting period.
- ▶ **It shows the firm's financial position at a specific point in time.**
- ▶ It summarizes the firm's revenues and expenses over an accounting period.

Question No: 19 ( Marks: 1 ) - Please choose one

All of the following are the disadvantages of a Corporate form of an organization EXCEPT:

- ▶ Double taxation
- ▶ Limited liability
- ▶ **Legal restrictions**
- ▶ None of the given options

Question No: 20 ( Marks: 1 ) - Please choose one

Which of the following would be a consequence of a high Inventory Turnover Ratio?

- ▶ Low level of inventory and frequent stock-outs
- ▶ Seasonal elements peculiar to the business
- ▶ **Efficient inventory management**
- ▶ Any of the given option

Question No: 21 ( Marks: 1 ) - Please choose one

Suppose you invested Rs. 8,000 in a savings account paying 5 percent interest a year, compounded annually. How much amount your account will have at the end the end of four years?

- Rs.10,208
- ▶ **Rs.9,728**
- ▶ Rs.10,880
- ▶ Rs.9,624

Question No: 22 ( Marks: 1 ) - Please choose one

Which of the following is the main source of income for the buyer of a zero-coupon bond?

- ▶ Price appreciation
- ▶ A rate of return equal to zero over the life of the bond
- ▶ Variable dividends instead of a fixed interest payment annually
- ▶ **All interest payments in one lump sum at maturity**

Zero coupon bonds, also called strip coupons, residuals, sentinels or just strips, are innovative fixed income products offering compound interest and a guaranteed future value if held to maturity.

Zero coupon bonds are bonds which do not pay periodic coupons, or so-called "interest payments". These bonds are purchased at a discount from what they will be worth when they mature. The holder of a zero coupon bond is entitled to receive a single payment, usually of a specified sum of money at a specified time in the future. An investor who has a regular bond receives income from coupon payments, which are usually made semi-annually. The investor also receives the principal or face value of the investment when the bond matures.

Question No: 23 ( Marks: 1 ) - Please choose one

Which of the following techniques of stock evaluation considers quantitative factors as well as qualitative factors for valuation?

- ▶ Technical Analysis
- ▶ **Fundamental Analysis**
- ▶ Constant Growth Model
- ▶ No Growth Model

The biggest part of fundamental analysis involves delving into the financial statements. Also known as quantitative analysis, this involves looking at revenue, expenses, assets, liabilities and all the other financial aspects of a company. Fundamental analysts look at this information to gain insight on a company's future performance. A good part of this tutorial will be spent learning about the balance sheet, income statement, cash flow statement and how they all fit together.

But there is more than just number crunching when it comes to analyzing a company. This is where qualitative analysis comes in - the breakdown of all the intangible, difficult-to-measure aspects of a company. Finally, we'll wrap up the tutorial with an intro on valuation and point you in the direction of additional tutorials you might be interested in.

Question No: 24 ( Marks: 1 ) - Please choose one

Which of the following statements is CORRECT regarding the fundamental analysis?

- ▶ Fundamental analysts use only Economic indicators to evaluate a stock
  - ▶ Fundamental analysts use only financial information to evaluate a company's stocks
  - ▶ **Fundamental analysts use financial and non-financial information to evaluate a company's stocks**
  - ▶ Fundamental analysts use only non-financial information to evaluate a company's stocks
- fundamental information that is analyzed can include a company's financial reports, and non-financial information such as estimates of the growth of demand for competing products, industry comparisons, analysis of the effects of new regulations or demographic changes, and economy-wide changes

Question No: 25 ( Marks: 1 ) - Please choose one

Which of the following could be used to calculate the cost of common equity?

- ▶ Interpolation method
- ▶ Dividend discount model
- ▶ YTM (Yield-to-Maturity) method
- ▶ **Capital structure valuation**

Capital structure of a typical company may consist of ordinary shares, preference stock, short term and long-term loan, bonds and leases. These components in capital structure have their own cost and if we add all the individual components cost after adjusting with the weight age of each, the resultant value is known as weighted cost of capital. In order to compute the WACC we need to calculate the

individual components cost. First of all we take up the Equity part of the capital and will see how we can compute the cost of equity.

Question No: 26 ( Marks: 1 ) - Please choose one

Which of the following is a long-term source of financing for a firm?

- ▶ **Corporate bonds**
- ▶ Money market instruments
- ▶ Trade credit
- ▶ Accounts payables

A **corporate bond** is a bond issued by a corporation. It is a bond that a corporation issues to raise money in order to expand its business. <sup>[1]</sup>The term is usually applied to longer-term debt instruments,

Question No: 27 ( Marks: 1 ) - Please choose one

Since the capital budgeting techniques use cash flows instead of accounting flows, therefore, the financial manager must add back which one of the following to the analysis?

- ▶ The cost of fixed assets
- ▶ The cost of accounts payable
- ▶ Investments
- ▶ **Depreciation**

Page 83 Profit before interest and income taxes xx,xxx

Add back depreciation xx,xxx

Add back amortization of goodwill

Question No: 28 ( Marks: 1 ) - Please choose one

Which of the following statements is correct for a project with a positive Net Present Value (NPV)?

- ▶ **Internal rate of return (IRR) exceeds the cost of capital**
- ▶ Accepting the project has an indeterminate effect on shareholders
- ▶ The discount rate exceeds the cost of capital
- ▶ The profitability index equals one

Which of the following is the last step in the financial planning process ?

- Providing feedback
- Taking corrective measures
- Implementing the plan**
- Controlling



A company has a dividend yield of 8%. If its dividend is expected to grow at a constant rate of 5%, what must be the expected rate of return on the company's stock?

14%

**13%**

12%

10%

Which of the following methods would be most suitable for calculating the return on stocks of a non-listed company?

**Dividend Growth model**

Capital Asset Pricing Model

Security Market Line

Characteristics line

Which of the following statements is true regarding Weighted Average Cost of Capital (WACC)?

WACC of a levered firm is greater than that of an un-levered firm

WACC of a levered firm is lesser than that of an un-levered firm

**WACC of a levered firm is equal to that of an un-levered firm**

An Un-levered firm has zero WACC

An un-gearred beta refers to the beta of a firm with:

100% Debt financed

100% Equity financed

50% Equity and 50% Debt financed

**60% Equity and 40% Debt financed**      **not sure**

With respect to a Cash flow statement, which of the following would be considered as a cash inflow?

## Increase in current assets

- Decrease in current liability
- Increase in current liability
- Can not be determined

If you deposit \$12,000 per year for 16 years (each deposit is made at the beginning of each year) in an account that pays an annual interest rate of 15%, what will your account be worth at the end of 16 years?

- \$82,168.44
- \$71,450.82
- \$768,901.12**
- \$668,609.67**

## Question # 1 of 15

Which of the following investment criteria does not take the time value of money into consideration?

## Simple payback method (page#34)

- Net present value
- Profitability index
- Internal rate of return for borrowing projects

## Question # 2 of 15

Which of the following is the Dividend Payout ratio for a common stock?

Dividend per share: Market value per share





Earning per share: Intrinsic value per share

**Dividend per share: Earning per share**

Market value per share: intrinsic value per share

Ref:

[http://en.wikipedia.org/wiki/Dividend\\_payout\\_ratio](http://en.wikipedia.org/wiki/Dividend_payout_ratio)

## Question # 3 of 15

Cash discounts are offered by the seller to buyer in order to improve which of the following?

**Operating cycle**

Sales turnover

Company goodwill

Credit worthiness

Ref:

**Operating Cycle = age of inventory + collection period.**

The *operating cycle* is the number of days from cash to inventory to accounts receivable to cash.

And

[http://www.slideshare.net/sagar\\_sjpuc/working-capital-management-presentation-775445](http://www.slideshare.net/sagar_sjpuc/working-capital-management-presentation-775445) in slide #3

## Question # 4 of 15

Average beta has value equal to:

**1 Slid # 16**

2

3

4

## Question # 5 of 15

Which of the following may be a major reason for hard capital rationing?

Dilution of earning per share (EPS)

High interest expense

High interest rate (SLIDE 13 BOOK PAGE 44)

Company own policies

## Question # 6 of 15

In inventory management, the storage cost of inventory is considered as:

Carrying cost Page#97

Reorder cost

Stock out cost

Safety cost

Ref:

## What Is Inventory Carrying Cost?

The cost to carry inventory measures the overhead that an organization carries to support its inventory. In addition to the money originally spent to purchase it, more money will be spent on upkeep while inventory sits in your possession. The longer the inventory is there, the more it will cost in upkeep. Carrying cost is usually expressed as a percentage that represents the cents per dollar that will be spent on inventory overhead *per year*.

Or

## Question # 7 of 15

Which of the following statement is TRUE regarding temporary working capital?

**Temporary working capital varies with seasonal requirements**

Temporary working capital is the constant component of working capital

Temporary working capital excludes inventories

Temporary working capital should be financed with bonds or common stock

**Ref:**

Temporary Working capital

The temporary or varying working capital varies with the volume of operations. It fluctuates with the scale of operations. This is the additional working capital required from time to time over and above the permanent or fixed working capital. **During seasons, more production/sales take place resulting in larger working capital needs.** The reverse is true during off-seasons. As seasons vary, temporary working capital requirement moves up and down. Temporary working capital can be financed through short term funds like current liabilities. When the level of temporary working capital moves up, the business might use short-term funds and when the level for temporary working capital recedes, the business may retire its short-term loans

OR

[http://www.tutorsonnet.com/homework\\_help/working\\_capital\\_management/permanent\\_and\\_temporary\\_working\\_capital\\_online\\_tutoring.htm](http://www.tutorsonnet.com/homework_help/working_capital_management/permanent_and_temporary_working_capital_online_tutoring.htm)

## Question # 8 of 15

Which of the following describes the hedging approach to financing?

Maturity dates of financing instruments are spread over a period of time so that they mature in a steady, predictable fashion

Each asset is offset with a financing instrument of the same approximate maturity

Each asset is offset with a put or call option.

The firm takes out insurance to protect itself against uneven cash flows.

## Question # 9 of 15

If the Internal Rates of Return of two, mutually exclusive options are both greater than the cost of capital, which option should be selected under the Internal Rate of Return method?

The one with the largest Internal Rate of Return. (Damn sure)

The one with the smallest Internal Rate of Return.

The one with the highest Net Present Value at the firm's cost of capital.

None of the given options

## Question # 10 of 15

Which of the following measures systematic risk of a firm's common stock?

Beta (PAGE 50)

CAPM

MM-Model

SML

## Question # 11 of 15

Which of the following is closely related to a sales budget?

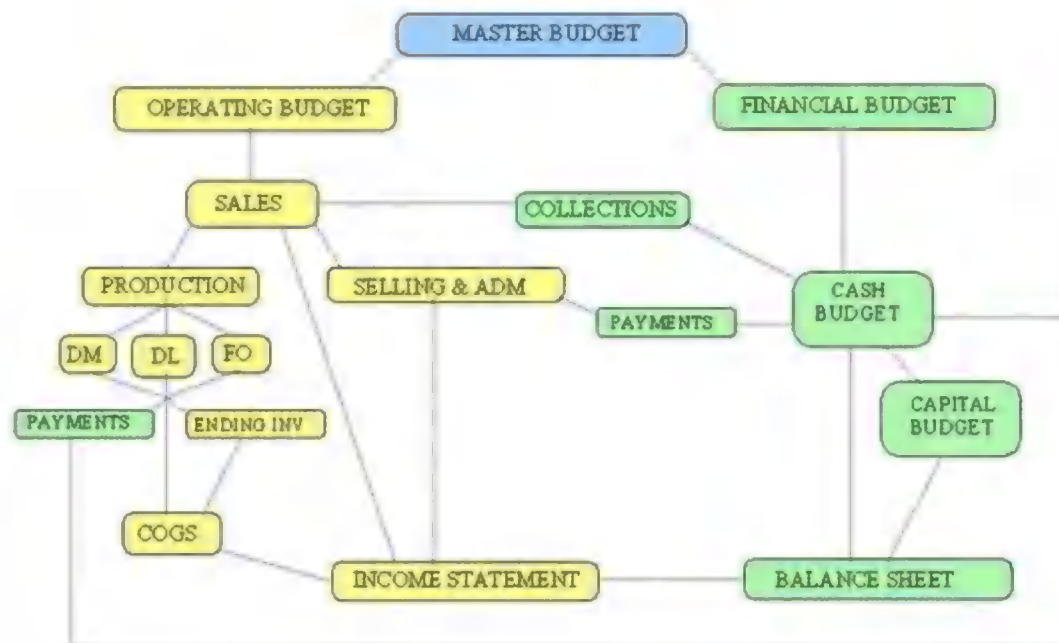
**Miscellaneous income**

Future profits

Cash outflow

Cash inflow

EXHIBIT 9-4  
DIAGRAM OF A MASTER BUDGET\*



The master budget has two major parts including the operating budget and the financial budget (See Exhibit 9-4). The operating budget begins with the sales budget and ends with the budgeted income statement. The financial budget includes the capital budget as well as a cash budget, and a budgeted balance sheet

## Question # 12 of 15

Which of the following is the correct definition for "spread" in cash management?

The difference between optimal cash balance and Nominal Cash balance

The difference between opening cash balance and ending cash balance.

**The difference between upper limit and lower limit of cash balances**

The difference between optimal cash balance and ending cash balance

Ref:

**Page#96 Graph**

## Question # 13 of 15

Which of the following statement is CORRECT regarding residual dividend policy?

Shareholders are paid dividend from capital

**Dividend are paid after meeting all the financial needs of the firm**

The management sets a fixed payout ratio

Shareholders are paid fixed dividend every year

Ref:

**Page#76**

## Residual Dividend Policy

If a company does not pay all the profit to shareholders in the form of dividend then the debt equity ratio

will change. **In this section we will assume that company do have some potential opportunities and will**





finance these opportunities first and any remainder profit will be paid as dividend and the debt equity ratio

will be held constant

## Question # 14 of 15

Total Marks: 1

Since companies in some industries typically have high fixed costs, but have stable and predictable revenues. Which of the following statement would be TRUE about these companies?

Their degree of operating leverage is relatively low.

Their bond issues would tend to have a speculative rating.

**Their overall business risk is relatively low. (Doubt)**

They are unable to take on much additional financial risk.

## Question # 15 of 15

Which of the following changes will occur if a bond's yield-to-maturity increases, keeping other things equal ?

Its price will rise

Its price will remain unchanged

**Its price will fall. (Sure)**

Can not be determined

## Question # 1 of 15

Since preferred stock dividends are fixed, valuing preferred stock is roughly equivalent to valuing:

**A zero growth common stock.**

A positive growth common stock

A short-term bond

An option.

**Question # 2 of 15**

Which one of the following statements is TRUE regarding future value of a single sum?

**Increase if the interest rate increases.**

Remains unchanged if the interest rate changes

Decrease if the interest rate increases

All of the given options

**Example:** You can afford to put \$10,000 in a savings account today that pays 6% interest compounded annually. How much will you have 5 years from now if you make no withdrawals?

$$PV = 10,000$$

$$i = .06$$

$$n = 5$$

$$FV = 10,000 (1 + .06)^5 = 10,000 (1.3382255776) = 13,382.26$$

End of Year	1	2	3	4	5
Principal	10,000.00	10,600.00	11,236.00	11,910.16	12,624.77

<b>Interest</b>	600.00	636.00	674.16	714.61	757.49
<b>Total</b>	<b>10,600.00</b>	<b>11,236.00</b>	<b>11,910.16</b>	<b>12,624.77</b>	<b>13,382.26</b>

## Question # 3 of 15

All of the following are the methods to evaluate the credit worthiness in business EXCEPT:

Market reputation

Previous payment record

**Production plant capacity**

Financial strength

Ref:

Page#104

credit worthiness in business

Financial statements of vendor

Market reputation

Banks

Previous payment record

Financial strength

Capacity

General economic conditions in vendors industry

## Question # 4 of 15



What is the main purpose of constructing a portfolio of financial assets?

To maximize risk and minimize the return

To minimize the risk and minimize the return

**To maximize the return and minimize the risk**

To minimize the return and minimize the risk

## Question # 5 of 15

Which of the following is tax deductible?

Dividend on preferred shares

Dividend on common stocks

Coupon payments on bonds

**Capital gain on common stocks**

## Question # 6 of 15

Inventory between various stages of production is known as:

Work in Process inventory

Finished goods inventory

Balanced goods inventory

**Raw materials inventory(Doubt)**

## Question # 7 of 15

Which of the following effects should be considered by a firm if it allows credit to its customers?



Cost of discount

Arrange loans to finance short term operations

Prices of goods

**All of the given options**

**Ref:**

**page#104**

## Question # 8 of 15

Which of the following is most relevant to a company's ability to pay off its short-term obligation?

Dividend Policy

**Net working capital**

Operating Cycle

Profitability

**Ref:**

## Working Capital

Working Capital is simply the amount that current assets exceed current liabilities. Here it is in the form of the equation:

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

This formula is very similar to the current ratio. The only difference is that it gives you a dollar amount rather than a ratio. It too is calculated to determine **a firm's ability to pay its short-term obligations**. Working Capital can be viewed as somewhat of a security blanket. The greater the amount of Working Capital, the more security an investor can have that they will be able to meet their financial obligations.

OR



## Question # 9 of 15

Which of the following is prepared by combining all the functional budgets?

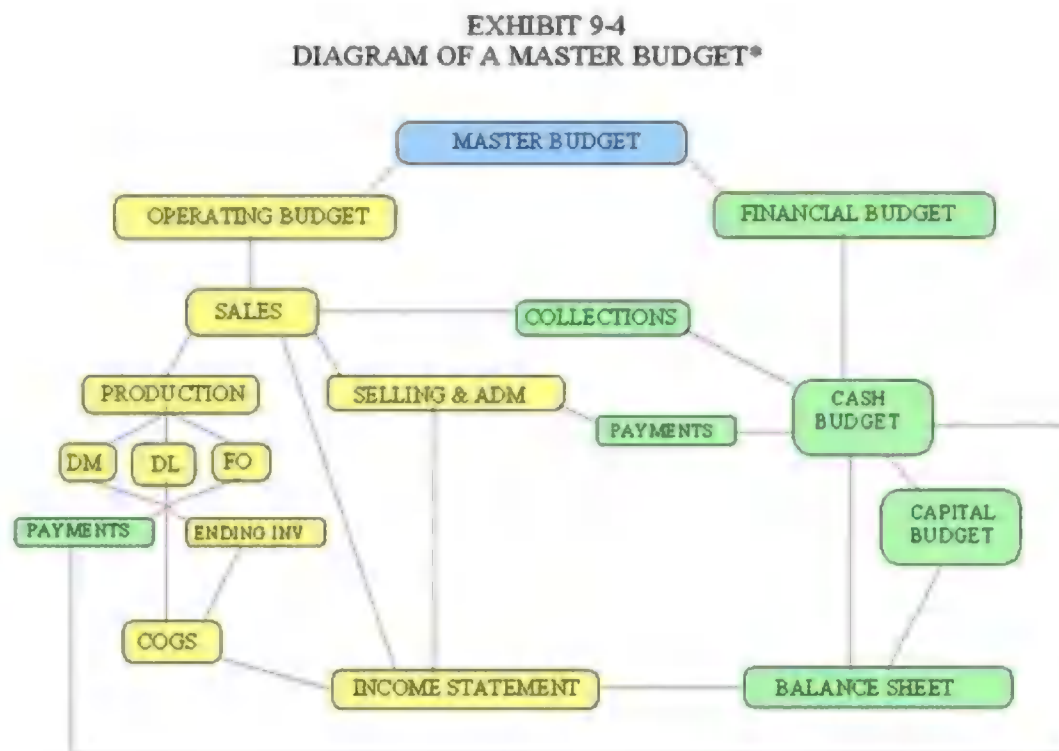
A production budget

A cash budget

A sales budget

**A master budget**

Ref:





## Question # 10 of 15

Which of the following should be ignored, while evaluating the financial viability of a project?

Initial cost

Equipment cost

Cost of capital

**Sunk cost**

## Question # 11 of 15

A company has a dividend yield of 8%. If its dividend is expected to grow at a constant rate of 5%, what must be the expected rate of return on the company's stock?

14%

**13%**

12%

10%

**Ref:  $r = \text{DIV}^1/P^0 + g =$**

**$8\% + 5\% =$**

**13%**

## Question # 12 of 15

Determine a firm's total asset turnover (TAT) if its net profit margin (NPM) is 5 percent, total assets are \$8 million, and ROI is 8 percent.

1.60

2.05

2.50

4.00

Ref:  $(ROI) / (NPM) = TAT$

$(.08) / (.05) = 1.6$

## Question # 13 of 15

Which of the following condition if exist will make the diversification more effective?

Securities contained in a portfolio are positively correlated

Securities contained in a portfolio are negatively correlated

Securities contained in a portfolio have high market values

Securities contained in a portfolio have low market values

OR

The most effective portfolio diversification will come from making investments that show negative correlation to each other. However, simply by investing in companies who show returns that are not correlated perfectly to each other, the risk in the portfolio will be lower than the associated risk of any individual stock.

## Question # 14 of 15

Which one of the following is a major limitation of Linear Programming Technique of capital projects selection?



## Ignores the relative size of the Investment (slide 14)

Time value of money is not considered

Project cash flows are ignored

Project profitability is ignored

### Question # 15 of 15

Holding everything else constant, increasing fixed costs \_\_\_\_\_ the firm's break-even point.

Decreases

Increases the covariance of

**Increases(Doubt)**

Does not affect

.

The employment of fixed costs associated with the actual production of goods or services is known as:

- Financial leverage
- Volume discounting
- Operating leverage**
- Covariance

Which of the following is a planning tool?

- A budget**
- A balance sheet

- An income statement
- A Cash flow statement

Which of the following would lower a firm's operating break-even point?

- An increase in the cost of goods sold
- An increase in selling price**
- An increase in wages paid to employees
- An increase in total sales

Suppose you have a 2-stocks portfolio, which consists of Stock A and Stock B. If stock A has a beta value of 1.8 and stock B has a beta value of 0.68, and your investment in stock A and stocks B is equal, then the beta of this 2-stock portfolio would be equal to:

Select correct option:

- 1.20
- 1.24**
- 1.30
- 1.45

Which of the following is a disadvantage of Capital Asset Pricing model?

- It consider market risk
- It can be used for listed companies
- It can be used for Non-listed companies
- It is based on Past data**

Which of the following statements applies to Dividend Growth Model?

- It is difficult to understand and use
- It is used for non-listed companies
- It is used for debt securities also
- It do not consider risk level of a security**



Which of the following changes will occur if a bond's yield-to-maturity increases, keeping other things equal?

- Its price will rise
- Its price will remain unchanged
- Its price will fall.**
- Can not be determined

A company has fixed costs of \$50,000 and variable costs per unit of output of \$8. If its sole product sells for \$18, what is the break-even quantity of output?

Select correct option:

- 2,500
- 5,000**
- 1,500
- 7,500

REF:  $BEQ = FC / P - VC$   
 $= 50000 / 18 - 8$   
 $= 50000 / 10 = 5000$

Which of the following is included in the cost of capital of a firm?

- Cost of sales
- Depreciation cost
- Depletion cost
- Cost of retained earnings**

Holmes Aircraft recently announced an increase in its net income, yet its net cash flow declined relative to last year. Which of the following could explain this performance?

- The company's taxes increased.
- The company's depreciation expense declined.**
- The company's operating income declined.
- All of the given statements are correct.

A market portfolio has a beta equal to:

0

1

2

3

A Levered firm has a lower weighted average cost of capital as compare to an Un-levered firm because of:

### Interest tax shield

Low level of financial risk  
Low level of business risk  
Low level of systematic risk

A dividend payment made in the form of additional shares, rather than a cash payout is known as:

### Stock Dividend

Cum Dividend  
Ex Dividend  
Extra Dividend

Which of the following method can be used to forecast the sales of a firm?

Price – earning ratio  
Cash flow estimation  
**Fundamental Analysis**      **not sure**  
Regression Analysis

Dividend discount Model states that today's price of a stock is equal to:

### The Present Value of all future dividends of the stock      page 115

The Present Value of the face value of the stock  
The Present Value of the Sales price of the stock  
The Present Value of the book value of the stock



The decision rule for net present value is to:

Accept all projects with cash inflows exceeding initial cost.

Reject all projects with rates of return exceeding the opportunity cost of capital.

**Accept all projects with positive net present values.**

Reject all projects lasting longer than 10 years.

Which of the following capital budgeting technique ignores profitability and time value of money?

Net Present Value

Internal Rate of Return

Discounted Pay Back period

**Simple Pay Back Period**

Since capital budgeting uses cash flows instead of accounting flows, the financial manager must add back \_\_\_\_\_ to the analysis.

The cost of fixed assets

The cost of accounts payable

Investments

**Depreciation**

In the formula  $r_E = (D_1/P_0) + g$ , what does the symbol "g" represent?

The expected price appreciation yield from a common stock.

**The expected dividend yield from a common stock.**

The dividend yield from a preferred stock.

The interest payment from a bond.

Which of the following is an objective of an optimal capital structure?

Select correct option:

To minimize the cost of capital

To minimize cost of equity



**To minimize cost of debt      not sure**

To minimize cost of sales

If sensitivity analysis concludes that the largest impact on profits would come from changes in the sales level, then which of the following recommendations should be considered?

Fixed costs should be traded for variable costs

Variable costs should be traded for fixed costs.

The project should not be undertaken.

**Additional marketing analysis may be beneficial before proceeding.**

Suppose you wish to set aside Rs.2,000 at the end of each of the next 10 years in an account paying 12 percent compounded annually. You accumulate at the end of 10 years an amount closest to:

Select correct option:

Rs.22,456

**Rs.35,098**

Rs.28,324.

Rs.20,324

Which of the following investment criteria does not take the time value of money into consideration?

**Simple payback method      page 35**

Net present value

Profitability index

Internal rate of return for borrowing projects

WWhich of the following would be consistent with a more aggressive (i.e., a high risk profitability) approach to financing working capital?

Financing permanent inventory buildup with long-term funds.

**Financing seasonal needs with short-term funds.**

Financing short-term needs with short-term funds.

Financing some long-term needs with short-term funds

If a creditor wanted to know if a potential customer paid its bills on time, the creditor could look at the potential customer's:

Current ratio.

Acid ratio.

**Average age of accounts payable.**

Average age of accounts receivable

Which of the following best illustrates the problem imposed by capital rationing?

Select correct option:

**Accepting projects with the highest NPVs first**

Accepting projects with the highest IRRs first

Bypassing projects that have positive NPVs

Bypassing projects that have positive IRRs

Present value of Rs.5, 000 received at the end of 5 years, discounted at 10 percent, is closest to:

**Rs.3, 105.**

Rs.823.

Rs.620.

Rs.3, 403.

Which of the following statement best describe the term Market Correction?

**Market Correction refers to the situation where equilibrium of supply & demand of shares occurs in the market**

Market correction occurs when shares' intrinsic values becomes equal to face values

Market Correction occurs when there is a boom in the economy

Market Correction occurs when inflation rate is above the market interest rate

Which of the following is the average time period between buying inventory and receiving cash proceeds from its eventual sale?



## Operating Cycle

Cash Cycle

Inventory period

Inventory Turnover

## Operating cycle

Average time period between buying inventory and receiving cash proceeds from its eventual sale. It is determined by adding the number of days inventory is held and the collection period for accounts receivable.

current assets of company exceed its current liabilities, then the company will have:

## A positive net working capital

A negative working capital

A net working capital of less than zero

A net working capital equal to zero

Which one of the following is a major limitation of Linear Programming Technique of capital projects selection?

## Ignores the relative size of the Investment

Time value of money is not considered

Project cash flows are ignored

Project profitability is ignored

Which of the following is tax deductible?

Select correct option:

Dividend on preferred shares

Dividend on common stocks

Coupon payments on bonds

**Capital gain on common stocks**

Which of the following focuses on long-term decision-making regarding the acquisition of projects?

Select correct option:

Working Capital Management

**Capital Budgeting**

Cash Budgeting

None of the given options

Question No: 1 ( Marks: 1 ) - Please choose one

Which of the following statements is TRUE regarding Profitability Index?

- ▶ It ignores time value of money
- ▶ It ignores future cash flows
- ▶ **It ignores the scale of investment**
- ▶ It ignores return on investment

Question No: 2 ( Marks: 1 ) - Please choose one

Which of the following is a tool that identifies the strengths, weaknesses, opportunities and threats of an organization?

- ▶ **SWOT Analysis**
- ▶ Trend Analysis
- ▶ Fundamental Analysis
- ▶ Technical Analysis

Question No: 3 ( Marks: 1 ) - Please choose one

Which of the following statements applies to intrinsic value of a security?

- ▶ **Intrinsic value of a security always exceeds its book value.**
- ▶ Intrinsic value of a security rises when the liquidation value falls.
- ▶ Intrinsic value of a security is the price around which its market value should closely fluctuate.
- ▶ Intrinsic value of a security is its closing market value when it is actively traded.

**Intrinsic Value** (also known as fundamental value) refers to the actual value of a security based on an underlying perception of its true value due to both tangible and intangible factors. The value may defer from the current market value. As a result, value investors use an array of analytical techniques to estimate the value of the security in the hope finding investments where the true value of the investment exceeds its current market value. It can be calculated by summing the future income generated by the assets, and discounting it to the present value.

Question No: 4 ( Marks: 1 ) - Please choose one

A Company's common stock is currently selling at Rs.3.00 per share, its quarterly dividend is Rs.0.07, and the stock is expected to rise to Rs.3.30 in a year. What is its expected rate of return?

- ▶ 9.3%
- ▶ 19.3%
- ▶ **10.0%**
- ▶ 11.0%

Question No: 5 ( Marks: 1 ) - Please choose one

For a firm with a Degree of Operating Leverage of 3.5, an increase in sales of 6% will:

- ▶ Increase pre-tax profits by 3.5%
- ▶ Decrease pre-tax profits by 3.5%.
- ▶ **Increase pre-tax profits by 21.0%.**
- ▶ Increase pre-tax profits by 1.71%.

Question No: 6 ( Marks: 1 ) - Please choose one

Which of the following best illustrates the problem imposed by capital rationing?

- ▶ **Accepting projects with the highest NPVs first**
- ▶ Accepting projects with the highest IRRs first
- ▶ By passing projects that have positive NPVs
- ▶ Bypassing projects that have positive IRRs

Capital Rationing occurs when a company has more amounts of capital budgeting projects with positive net present values than it has money to invest in them. Therefore, some projects that should be accepted are excluded because financial capital is limited.

Question No: 7 ( Marks: 1 ) - Please choose one

A project would be financially feasible in which of the following situations?

- ▶ If Internal Rate of Return of a project is greater than zero
- ▶ If Net Present Value of a project is less than zero
- ▶ If the project has Profitability Index less than one
- ▶ **If the project has Profitability Index greater than one**

The PI would be larger than 1 for positive NPV projects and less than 1 for negative NPV projects.

Question No: 8 ( Marks: 1 ) - Please choose one

Suppose a stock is selling today for Rs.35 per share. At the end of the year, it pays a dividend of Rs.2.00 per share and sells for Rs.39.00. What is the dividend yield on this stock?

- ▶ 2%
- ▶ 3%
- ▶ 4%
- ▶ **5%**





**Dividend yield = Annual dividends per share / price per share**  
 = 2 / 35  
 = 0.057 = 5%

Question No: 9 ( Marks: 1 ) - Please choose one

Which of the following is considered as a risk free financial asset?

- ▶ **Government T-bills**
- ▶ Junk bonds
- ▶ Preferred stock
- ▶ Secured bonds

Question No: 10 ( Marks: 1 ) - Please choose one

Which of the following is a necessary condition for issuing shares through Initial Public Offerings (IPO's)?

- ▶ The firm must have a stable dividend policy
- ▶ The firm must have a low cost of capital
- ▶ The firm must have a low level of debt
- ▶ **The firm must be listed on the stock exchange**

Question No: 11 ( Marks: 1 ) - Please choose one

Which one of the following statements applies to Dividend Growth Model?

- ▶ It is difficult to understand and use
- ▶ It is used for non-listed companies
- ▶ It is used for debt securities also
- ▶ **It do not consider risk level of a security**

Question No: 12 ( Marks: 1 ) - Please choose one

Which of the following *best* define the term 'Capital Structure'?

- ▶ The proportion of equity used by a firm
- ▶ **The proportion of debt and equity capital used by a firm**
- ▶ The proportion of long-term liabilities used by a firm
- ▶ The proportion of short-term bank loan used by a firm

In finance, capital structure refers to the way a corporation finances its assets through some combination of equity, debt, or hybrid securities. A firm's capital structure is then the composition or 'structure' of its liabilities.

Question No: 13 ( Marks: 1 ) - Please choose one

A Pure Play method of selecting a discount rate is most suitable in which of the following situations?

- ▶ When the intended investment project has a Non-conventional stream of cash flows
- ▶ When the intended investment project is a replacement project

► **When the intended investment project belongs to industry other than the firms operating in**

► When the intended investment project has a conventional stream of cash flows

Question No: 14 ( Marks: 1 ) - Please choose one

Which of the following is a dividend that is paid in the form of additional shares, rather than a cash payout?

► **Stock Dividend**

► Cum Dividend

► Ex Dividend

► Extra Dividend

Question No: 15 ( Marks: 1 ) - Please choose one

Which of the following is a proposition of Miller and Modigliani theory of Capital structure?

► **Value of a firm is independent of its capital structure**

► Value of a firm is independent of its level of debt

► Value of a firm is dependent of its cost of capital

► Value of a firm is independent on its level of equity finances

Question No: 16 ( Marks: 1 ) - Please choose one

Which of the following transactions would occur in a primary financial market?

► **Initial public offering**

► Buying mutual funds certificates

► Selling old shares

► Buying bonds issued in previous year

Question No: 17 ( Marks: 1 ) - Please choose one

What will be the effect of reduction in the cost of capital on the accounting break-even level of revenues?

► It raises the break-even level.

► It reduces the break-even level.

► **It has no effect on the break-even level.**

► This cannot be determined without knowing the length of the investment horizon.

Question No: 18 ( Marks: 1 ) - Please choose one

Which of the following statements is TRUE regarding Balance Sheet of a firm?

► It reports how much of the firm's earnings were retained in the business rather than paid out in dividends.

► It reports the impact of a firm's operating, investing, and financing activities on cash flows over an accounting period.

- ▶ **It shows the firm's financial position at a specific point in time.**
- ▶ It summarizes the firm's revenues and expenses over an accounting period.

Question No: 19 ( Marks: 1 ) - Please choose one

All of the following are the disadvantages of a Corporate form of an organization EXCEPT:

- ▶ Double taxation
- ▶ Limited liability
- ▶ **Legal restrictions**
- ▶ None of the given options

Question No: 20 ( Marks: 1 ) - Please choose one

Which of the following would be a consequence of a high Inventory Turnover Ratio?

- ▶ Low level of inventory and frequent stock-outs
- ▶ Seasonal elements peculiar to the business
- ▶ **Efficient inventory management**
- ▶ Any of the given option

Question No: 21 ( Marks: 1 ) - Please choose one

Suppose you invested Rs. 8,000 in a savings account paying 5 percent interest a year, compounded annually. How much amount your account will have at the end the end of four years?

- Rs.10,208
- ▶ **Rs.9,728**
- ▶ Rs.10,880
- ▶ Rs.9,624

Question No: 22 ( Marks: 1 ) - Please choose one

Which of the following is the main source of income for the buyer of a zero-coupon bond?

- ▶ Price appreciation
- ▶ A rate of return equal to zero over the life of the bond
- ▶ Variable dividends instead of a fixed interest payment annually
- ▶ **All interest payments in one lump sum at maturity**

Zero coupon bonds, also called strip coupons, residuals, sentinels or just strips, are innovative fixed income products offering compound interest and a guaranteed future value if held to maturity.

Zero coupon bonds are bonds which do not pay periodic coupons, or so-called "interest payments". These bonds are purchased at a discount from what they will be worth when they mature. The holder of a zero coupon bond is entitled to receive a single payment, usually of a specified sum of money at a specified time in the future. An investor who has a regular bond receives income from coupon payments, which are usually made semi-annually. The investor also receives the principal or face value of the investment when the bond matures.

Question No: 23 ( Marks: 1 ) - Please choose one

Which of the following techniques of stock evaluation considers quantitative factors as well as qualitative factors for valuation?

- ▶ Technical Analysis
- ▶ **Fundamental Analysis**
- ▶ Constant Growth Model
- ▶ No Growth Model

The biggest part of fundamental analysis involves delving into the financial statements. Also known as quantitative analysis, this involves looking at revenue, expenses, assets, liabilities and all the other financial aspects of a company. Fundamental analysts look at this information to gain insight on a company's future performance. A good part of this tutorial will be spent learning about the balance sheet, income statement, cash flow statement and how they all fit together.

But there is more than just number crunching when it comes to analyzing a company. This is where qualitative analysis comes in - the breakdown of all the intangible, difficult-to-measure aspects of a company. Finally, we'll wrap up the tutorial with an intro on valuation and point you in the direction of additional tutorials you might be interested in.

Question No: 24 ( Marks: 1 ) - Please choose one

Which of the following statements is CORRECT regarding the fundamental analysis?

- ▶ Fundamental analysts use only Economic indicators to evaluate a stock
  - ▶ Fundamental analysts use only financial information to evaluate a company's stocks
  - ▶ **Fundamental analysts use financial and non-financial information to evaluate a company's stocks**
  - ▶ Fundamental analysts use only non-financial information to evaluate a company's stocks
- fundamental information that is analyzed can include a company's financial reports, and non-financial information such as estimates of the growth of demand for competing products, industry comparisons, analysis of the effects of new regulations or demographic changes, and economy-wide changes

Question No: 25 ( Marks: 1 ) - Please choose one

Which of the following could be used to calculate the cost of common equity?

- ▶ Interpolation method
- ▶ Dividend discount model
- ▶ YTM (Yield-to-Maturity) method
- ▶ **Capital structure valuation**

Capital structure of a typical company may consist of ordinary shares, preference stock, short term and long-term loan, bonds and leases. These components in capital structure have their own cost and if we add all the individual components cost after adjusting with the weight age of each, the resultant value is known as weighted cost of capital. In order to compute the WACC we need to calculate the individual components cost. First of all we take up the Equity part of the capital and will see how we can compute the cost of equity.

Question No: 26 ( Marks: 1 ) - Please choose one

Which of the following is a long-term source of financing for a firm?

- ▶ **Corporate bonds**
- ▶ Money market instruments
- ▶ Trade credit
- ▶ Accounts payables

A **corporate bond** is a bond issued by a corporation. It is a bond that a corporation issues to raise money in order to expand its business. <sup>[1]</sup>The term is usually applied to longer-term debt instruments,

Question No: 27 ( Marks: 1 ) - Please choose one

Since the capital budgeting techniques use cash flows instead of accounting flows, therefore, the financial manager must add back which one of the following to the analysis?

- ▶ The cost of fixed assets
- ▶ The cost of accounts payable
- ▶ Investments
- ▶ **Depreciation**

Page 83 Profit before interest and income taxes xx,xxx

Add back depreciation xx,xxx

Add back amortization of goodwill

Question No: 28 ( Marks: 1 ) - Please choose one

Which of the following statements is correct for a project with a positive Net Present Value (NPV)?

- ▶ **Internal rate of return (IRR) exceeds the cost of capital**
- ▶ Accepting the project has an indeterminate effect on shareholders
- ▶ The discount rate exceeds the cost of capital
- ▶ The profitability index equals one

Which of the following is the last step in the financial planning process ?

- Providing feedback
- Taking corrective measures



**Implementing the plan**

## Controlling

A company has a dividend yield of 8%. If its dividend is expected to grow at a constant rate of 5%, what must be the expected rate of return on the company's stock?

14%

**13%**

12%

10%

Which of the following methods would be most suitable for calculating the return on stocks of a non-listed company?

**Dividend Growth model**

Capital Asset Pricing Model

Security Market Line

Characteristics line

Which of the following statements is true regarding Weighted Average Cost of Capital (WACC)?

WACC of a levered firm is greater than that of an un-levered firm

WACC of a levered firm is lesser than that of an un-levered firm

**WACC of a levered firm is equal to that of an un-levered firm**

An Un-levered firm has zero WACC

An un-gearred beta refers to the beta of a firm with:

100% Debt financed

100% Equity financed

50% Equity and 50% Debt financed

**60% Equity and 40% Debt financed**      **not sure**



With respect to a Cash flow statement, which of the following would be considered as a cash inflow?

**Increase in current assets**

Decrease in current liability

Increase in current liability

Can not be determined

If you deposit \$12,000 per year for 16 years (each deposit is made at the beginning of each year) in an account that pays an annual interest rate of 15%, what will your account be worth at the end of 16 years?

\$82,168.44

\$71,450.82

**\$768,901.12 (Azeem ans)**

**\$668,609.67**

$$fv = p * (((1 + i) ^ n - 1) / i) * (1 + i)$$

$$12000 * (((1.15)^{16} - 1) / 0.15) * (1 + 0.15)$$

$$768901.1$$

## Q#1

Determining the mix of debt and equity to be used to finance a firm is which type of a decision?

A) capital budgeting

B) working capital

**C) capital structure**

## Q#2

Which one of the following statements concerning partnerships is correct?

- A) All partners enjoy limited liability if they create a general partnership of equal shares.
- B) A limited partner actively participates in running the partnership on a daily basis.
- C) A general partnership terminates whenever one general partner decides to sell her share of the business.**
- D) A general partnership has an unlimited life while a limited partnership has a limited life.

## Q#3

Which one of the following statements concerning corporations is correct?

- A) The rules describing how a corporation regulates its own existence are set forth in the bylaws.**
- B) The procedures to be followed for electing corporate directors are included in the articles of incorporation.
- C) Corporate income is taxed only when the corporate earnings are distributed to shareholders.
- D) A corporation is the easiest form of business entity to create.

## Q#4

The goal of financial management is to maximize the current:

- A) net income per share.
- B) dividends per share.
- C) total assets.
- D) market value per share.**

## Q#5

Which one of the following statements concerning the financial markets is correct?

- A) Shareholders exchange shares with each other in the primary market.
- B) The New York Stock Exchange is an auction market.**
- C) Dealer markets have a physical trading floor.
- D) Stocks traded in auction markets are said to trade over-the-counter.

## Q#6

Which one of the following provides limited liability for all of its owners?

- A) sole proprietorship
- B) partnership with only general partners
- C) partnership with both general and limited partners
- D) corporation**

## Q#7

Which one of the following represents a potential agency problem?

- A) adherence to the Sarbanes-Oxley Act in 2002
- B) hiring a manager and compensating her with shares of company stock
- C) paying a management bonus based on the number of employees managed**
- D) paying all company earnings out to shareholders in the form of dividends

## Q#8

Firms that "went dark" following the enactment of the Sarbanes-Oxley Act in 2002:

- A) must still comply with all the terms of that act.
- B) did not meet the requirements of the act and were involuntarily delisted by the SEC.
- C) generally did so to avoid the high cost of compliance.**
- D) now trade on NASDAQ where previously the firm's shares were traded on the NYSE.

## Q#9

Which one of the following is found in the corporate bylaws?



- A) intended life of the corporation
- B) the state of residence
- C) the number of shares that can be issued
- D) the procedures for electing the directors**

## Q#10

Which one of the following statements concerning financial markets is correct?

- A) The NYSE is an auction market.**
- B) All dealer markets require a physical trading floor.
- C) Corporations initially sell shares of stock in the secondary market, which is an auction market.
- D) All private sales of stock must first be registered with the SEC.

## Q#1

Use these financial statements to answer the question.

What is the amount of the change in net working capital?

**A) -\$800**

B) \$100

C) \$16,700

D) \$8,900

## Q#2

Use these financial statements to answer the question.

What is the net capital spending for 2009?

A) \$700

B) \$7,100

C) \$8,500

D) \$2,400

## Q#3

Use these financial statements to answer the question.

What is the total amount of stockholders' equity for 2009?



A) \$20,000

B) \$14,000

C) \$11,400

D) \$25,400

## Q#4

Use these financial statements to answer the question.

What are the earnings per share for 2009 if the par value per share is \$1?

A) \$0.11

B) \$0.15

C) \$0.08

D) \$0.06

## Q#5

Use these financial statements to answer the question.



How much was paid out to shareholders in the form of dividends during 2009?

A) \$1,600

B) \$5,100

C) \$1,700

D) \$5,200

**Q#6**

Use these financial statements to answer the question.

What is the amount of the operating cash flow?

A) -\$2,100

B) \$1,600

C) \$11,900

D) \$8,700

## Q#7

Use these financial statements to answer the question.

What is the cash flow from assets?

A) \$3,800

B) \$4,200

C) \$4,900

D) \$5,100

## Q#8

Use these financial statements to answer the question.

What is the cash flow to creditors?

A) \$2,500

B) -\$100

C) \$5,100



D) \$600

**Q#9**

Which one of the following assets is most liquid?

A) inventory

B) equipment

C) land

**D) accounts receivable**

**Q#10**

A firm has \$2,100 in net income, a tax rate of 35 percent, and interest expense of \$700. What is EBIT?

A) \$3,535

B) \$4,100

C) \$6,700

**D) \$3,931**

## Q#1

Use the following financial statements to answer the question.

What is the total debt ratio?

**A) 0.65**

B) 0.47

C) 0.52

D) 0.61

## Q#2

Use the following financial statements to answer the question.

How many days on average does it take the firm to sell its inventory?

A) 77.19 days



B) 84.59 days

C) 103.95 days

D) 96.07 days

Q#3

Use the following financial statements to answer the question.

What is the cash coverage ratio?

A) 4.08

B) 5.92

C) 8.41

D) 7.47

## Q#4

Use the following financial statements to answer the question.

What is the profit margin?

A) 6.67%

B) 7.08%

C) 7.29%

D) 7.47%

## Q#5

Use the following financial statements to answer the question.

What is the price-sales ratio is the price per share is \$8 and the par value per share is \$1?

A) 1.48

**B) 1.91**

C) 2.11

D) 2.36

**Q#6**

Use the following financial statements to answer the question.

What is the total asset turnover?

**A) 1.06**

B) 1.15

C) 1.21

D) 0.87

**Q#7**

Use the following financial statements to answer the question.

If the long-term debt had a balance of \$50,800 last year, then long-term debt is a \_\_\_\_\_ of cash this year.





A) source

**B) use**

Q#8

Use the following financial statements to answer the question.

If the accounts receivable account had a balance of \$12,500 last year, then the accounts receivable is a \_\_\_\_\_ of cash this year.

A) source

**B) use**

Q#9

Use the following financial statements to answer the question.

What is the price-earnings ratio if the par value per share is \$1 and the market price per share is \$7.50?

A) 18.01

**B) 25.34**

C) 22.16

D) 19.97

## Q#10

Use the following financial statements to answer the question.

What is the common-size ratio of the net fixed assets?

A) 0.56

B) 0.48

C) 0.62

D) 0.67

## Q#1

Use the following financial statements to answer the question.

Assume this firm is operating at 84 percent of capacity. What is the capital intensity ratio at full capacity sales?



A) 0.62

B) 0.91

C) 0.79

D) 0.84

Q#2

Use the following financial statements to answer the question.

Assume this firm has a constant dividend payout ratio and a constant debt-equity ratio. What is the maximum growth rate the firm can achieve without any external equity financing? Assume the firm is currently operating at full capacity.

A) 27.7%

B) 25.4%

C) 28.2%

D) 31.0%

**Q#3**

Use the following financial statements to answer the question.

Assume this firm is currently operating at 96 percent capacity. What is the required increase in fixed assets if sales are projected to increase by 12 percent?

A) \$2,006

B) \$4,929

**C) \$3,294**

D) \$1,507

**Q#4**

Use the following financial statements to answer the question.

Assume this firm has a constant dividend payout ratio and a projected sales increase of 3 percent. All costs, assets, and current liabilities vary directly with sales. The firm is currently at full production. What is the external financing need?

A) -\$2,511

B) \$4,263

C) \$1,919

D) -\$5,592

Q#5

Use the following financial statements to answer the question.

Assume the profit margin and dividend payout ratio are expected to remain constant. Sales are expected to increase by 6 percent next year. What is the projected total retained earnings at the end of next year?

A) \$27,122

B) \$28,832

C) \$30,333

D) \$34,625

Q#6

The plowback ratio is best defined as:

A) the profit margin minus the dividend payout ratio.

B) annual dividends paid divided by net income.

C) the change in retained earnings from one year to the next.

**D) one minus the dividend payout ratio.**

Q#7

The internal rate of growth assumes which one of the following?

A) 100 percent retention ratio

B) constant debt-equity ratio

C) additional debt financing but not equity financing

**D) no new external financing of any kind**

Q#8

You want to compile pro forma statements for your business. Which one of the following account values should you estimate first?

A) cash

**B) sales**



C) taxes

D) external financing need

Q#9

The capital intensity ratio should be computed based on which one of the following sales figures?

A) current year sales

B) pro forma year sales

C) full-capacity sales

D) average of current year and pro forma year sales

Q#10

A negative external financing need indicates that the firm:

A) will need to issue both debt and equity if it wants to achieve its desired level of growth.

**B) can grow at the expected rate without obtaining any additional external financing.**

C) the firm will need to decrease in size during the pro forma period.

D) will be unable to achieve its maximum rate of growth during the pro forma period

### Q#1

Gloria wants to have \$20,000 in her investment account ten years from now. Currently, she has nothing saved. How much would she have to deposit today to reach her goal if this is the only amount she invests? She expects to earn 8.5 percent, compounded annually. How much must she deposit today?

A) \$11,520.74

B) \$9,684.28

**C) \$8,845.71**

D) \$14,705.88

### Q#2

Four years ago, your baseball card collection was worth \$1,200. You have not added any cards to the collection over the past four years, but the collection has still increased in value. Today, it is worth \$1,500. What rate of return are you earning on this collection?

**A) 5.74 percent**

- B) 6.23 percent
- C) 4.98 percent
- D) 5.25 percent

## Q#3

Amy invested \$1,500 in a stock that has returned 12 percent, compounded annually. Today, that investment is worth \$3,600. How long has Amy owned this stock?

- A) 5.92 years
- B) 6.54 years
- C) 7.18 years
- D) 7.73 years**

## Q#4

When your parents got married 38 years ago, they purchased a house for \$31,900. They have taken good care of the house but have not invested any more money into it. Today, their house is valued at \$149,900. What rate of return have your parents earned on their home?

- A) 3.92 percent
- B) 4.16 percent**
- C) 4.58 percent
- D) 5.39 percent

## Q#5

Which one of the following statements is correct, assuming all else is constant?



- A) The discount rate increases as the present value increases.
- B) The future value decreases as the present value increases.
- C) The time period increases as the interest rate increases.
- D) The present value increases as the discount rate decreases.**

## Q#6

You invested \$5,000 at 6 percent simple interest for five years. How much total interest will you earn over these five years?

- A) \$300.00
- B) \$742.97
- C) \$1,500.00**
- D) \$1,691.13

## Q#7

Scott and Todd are twins. Scott invests \$50 a month for ten years starting on his 20th birthday. Todd invests \$50 a month for ten years starting on his 25th birthday. Both Scott and Todd earn 7 percent. Which one of the following statements is correct based on this information? Assume they never withdraw any money from their accounts.

- A) Both Scott and Todd will have the same amount saved when they turn 60 if the 7 percent is simple interest.
- B) Scott and Todd will earn the same amount of interest during the year of their 40th birthday if the 7 percent is simple interest.**

C) Todd will have more money saved than Scott when they are 70 years old if the 7 percent is compounded annually.

D) Scott and Todd will earn the same amount of interest during the year of their 50th birthday if the 7 percent is compounded annually.

## Q#8

Flo deposited \$5,000 into her retirement account today. How much money will she have 40 years from now if this is the only deposit she makes and she earns an average of 13 percent, compounded annually?

- A) \$597,264
- B) \$648,306
- C) \$663,908**
- D) \$671,909

## Q#9

You have been offered a business opportunity that will pay you \$57,000 in six years if you invest \$25,000 today. What is the expected rate of return on this investment?

- A) 14.72 percent**
- B) 15.36 percent
- C) 15.78 percent
- D) 16.22 percent

## Q#10

According to the Rule of 72, how long will it take you to double your money is you can earn a 6 percent rate of return?

- A) 6 years
- B) 7.2 years
- C) 9 years
- D) 12 years**

## Q#1

What is the interest rate per period multiplied by the number of periods per year called?

- A) effective annual yield
- B) compounded effective yield
- C) periodic rate
- D) annual percentage rate**

## Q#2

Your employer has offered to contribute \$50 a week to your retirement savings account. Assume you work for this employer for another 15 years and earn an average return of 8.5 percent, compounded weekly, on your savings. What is this offer worth to you today?

- A) \$39,000
- B) \$42,315

C) \$78,764

D) \$81,309

## Q#3

This morning, you purchased some stereo equipment costing \$2,659. You charged this purchase on your credit card. This card charges 16.9 percent interest, compounded monthly. How long will it take you to pay off this purchase if this is the only charge on your credit card and you make monthly payments of \$40?

A) 15.13 years

B) 12.95 years

C) 14.82 years

D) 16.40 years

## Q#4

Every month for the past eight years you have invested \$50 in a mutual fund. Today, your account is valued at \$6,419. What rate of return have you been earning on this investment?

A) 7.03 percent

B) 5.86 percent

C) 6.29 percent

D) 6.54 percent

## Q#5

You just purchased a home and agreed to a mortgage payment of \$1,264 a month for 30 years at 7.5 percent interest, compounded monthly. How much interest will you pay over the life of this mortgage assuming that you make all payments as agreed?

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- A) \$181,267
- B) \$274,266**
- C) \$387,280
- D) \$455,040

## Q#6

You are going to receive \$6,000 at the end of each quarter for the next five years. What is the net present value of these payments at a discount rate of 7 percent, compounded quarterly?

- A) \$63,564
- B) \$100,517**
- C) \$102,276
- D) \$103,012

## Q#7

What is the effective annual rate of 10.75 percent compounded continuously?

- A) 11.04 percent
- B) 11.19 percent
- C) 11.30 percent
- D) 11.35 percent**

## Q#8

A preferred stock pays annual dividends of \$1.80 per share. What is this stock worth to you today if you desire a 14.5 percent return on this investment?

- A) \$11.87
- B) \$12.41**
- C) \$25.98
- D) \$26.10

## Q#9

A project will produce cash flows of \$2,400, \$2,800, and \$4,100 a year for the next three years, respectively. What is the net value of these cash flows today if the applicable discount rate is 12 percent?

- A) \$7,778.80
- B) \$8,056.16
- C) \$7,293.30**
- D) \$8,303.57

## Q#10

Sue plans to save \$100 at the beginning of each month for the next five years. Scott plans to save \$100 at the end of each month for the next five years. Assume that both Sue and Scott earn 4.5 percent on their savings. Which one of the following statements is correct given this information?

- A) Sue will have \$6,721.68 at the end of the five years.
- B) Sue will have \$25.17 more in her account than Scott will have in his account at the end of the five years.**

- C) Scott will have \$8.67 more in his account than Sue will have in her account after the first three years.
- D) Both Sue and Scott will have the same amount of money in their accounts after five years.

## Q#1

Christine earned 7.5 percent on her investments last year. Her real rate of return was 4.6 percent. What was the inflation rate for the year?

- A) 2.62 percent
- B) 2.77 percent**
- C) 3.06 percent
- D) 3.49 percent

## Q#2

A zero coupon bond has a yield to maturity of 9.26 percent and 8 years until it fully matures. What is the current price of this bond if the face value is \$1,000? Assume semiannual compounding.

- A) \$458.80
- B) \$471.20
- C) \$484.73**
- D) \$503.72

## Q#3

Which one of the following bonds has the most interest rate risk?

- A) 6%, 20 year
- B) 6%, 10 year
- C) 0%, 10 year
- D) 0%, 20 year**

**Q#4**

Of the following ratings, which one is the lowest investment-quality bond rating by Standard & Poor's?

- A) Baa
- B) A
- C) BBB**
- D) B

**Q#5**

A semi-annual coupon bond is currently selling for \$747 and has a yield to maturity of 8.13 percent. The bond matures in 7 years. What is the coupon rate of this bond if the face value is \$1,000?

- A) 0 percent
- B) 3.32 percent**
- C) 8.47 percent
- D) 16.60 percent

**Q#6**

Miller Stores bonds are currently quoted at 97.54 percent of par and mature in 11 years. The bonds pay a \$30 semiannual coupon and have a \$1,000 face value. What is the current yield on these bonds?

- A) 3.00 percent
- B) 3.15 percent
- C) 6.15 percent**
- D) 6.00 percent

## Q#7

Which one of the following is the price you will pay if you buy a bond from a dealer?

- A) bid
- B) yield
- C) call
- D) asked**

## Q#8

Which one of the following terms is most associated with the ranking of a debt should a firm declare bankruptcy?

- A) seniority**
- B) indenture
- C) sinking fund
- D) positive covenant

## Q#9

Delta Pipe offers a 6 percent coupon bond with a yield to maturity of 6.5 percent. The bond pays interest annually and matures in 12 years. What is the market price of one of these bonds if the face value is \$1,000?

- A) \$959.21
- B) \$958.78
- C) \$947.27
- D) \$946.39

## Q#10

The Kandy Store has 7.5 percent semiannual bonds outstanding with 16 years to maturity. What is the yield to maturity if the bonds are currently selling for \$1,012.50 each?

- A) 6.98 percent
- B) 7.37 percent
- C) 7.54 percent
- D) 7.67 percent

## Q#1

The common stock of Wells Moving Co. is selling for \$28.95 a share and offers a 7.9 percent rate of return. If the dividend growth rate is constant at 2.5 percent, what is the next dividend expected to be?

- A) \$1.25

- B) \$1.38
- C) \$1.43
- D) \$1.56**

## Q#2

Concrete Rail Ties recently announced that it will pay its first annual dividend next year in the amount of \$0.45 a share. The dividend will be increased by 4 percent annually thereafter. How much are you willing to pay today for one share of this stock if you require a 10 percent rate of return?

- A) \$6.50
- B) \$6.80
- C) \$7.50**
- D) \$8.65

## Q#3

A market maker who operates at a post on the floor of the NYSE is called a:

- A) specialist.**
- B) floor broker.
- C) floor trader.
- D) commission broker.

## Q#4

Dry Goods and More is expected to pay annual dividends of \$1.15, \$1.20, and \$1.35 a share over the next three years, respectively. After that, the dividend is expected to increase by 2.5 percent annually. What is one share of this stock worth today if similar stocks are yielding a 9.5 percent return?

A) \$18.14

B) \$18.78

C) \$19.26

D) \$19.73

## Q#5

Which one of the following is used to appoint an individual to vote on your behalf at a shareholder's meeting?

A) post

B) proxy

C) DOT

D) yield

## Q#6

You own 100 shares of noncumulative, nonvoting, 8 percent preferred stock. Which one of the following statements is correct given this information?

A) The stock pays 8 percent of \$1,000 as the annual dividend.

B) You are guaranteed to receive \$800 of dividend income each year that you own these shares.

C) If the issuer skips multiple dividend payments, you may receive voting rights.



D) If the issuer skips one or more dividend payments, you will receive those payments prior to any common stock dividends being distributed.

## Q#7

Dixie South just paid an annual dividend of \$1.20 per share. The firm is expected to increase its dividend by 4 percent per year for the next 3 three years. After that, the dividend is expected to increase by 2.5 percent each year indefinitely. What is one share of this stock worth today at a discount rate of 12 percent?

- A) \$12.21
- B) \$12.54
- C) \$13.01
- D) \$13.48**

## Q#8

Bennington Brothers has 175,000 shares of stock outstanding with a market price of \$12.70 a share. You currently own 40,000 of these shares. The company has 3 open positions on its board of directors and uses cumulative voting. You realize that no one else will vote for you but you still want to be elected to the board. How much must you spend to purchase sufficient shares to guarantee your election?

- A) \$0
- B) \$47,638**
- C) \$232,846
- D) \$555,638

## Q#9



The Hen's Nest just paid an annual dividend of \$0.82 a share. What will the dividend be in year 4 if the dividend growth rate is 3 percent?

- A) \$0.88
- B) \$0.92**
- C) \$0.96
- D) \$1.00

## Q#10

Which one of the following statements related to equity securities is correct?

- A) Preferred shareholders generally receive two votes for every one vote granted to a common shareholder.
- B) If a dividend payment is missed on a cumulative preferred stock, the issuer must pay the missed dividend prior to paying any common stock dividends.**
- C) Dividend income received by an individual is exempt from federal taxation.
- D) The dividend growth model can be used to determine the value of any individual stock.

## Q#1

You are analyzing a proposed project and have compiled the following information:

What is the net present value of this proposed project?

A) -\$1,980

B) -\$611

C) \$867

D) \$2,011

**Q#2**

You are analyzing a proposed project and have compiled the following information:

Should the proposed project be accepted based on its internal rate of return? Why or why not?

A) yes; IRR = 12.28 percent

B) yes; IRR = 11.79 percent

C) no; IRR = 12.28 percent

D) no; IRR = 11.79 percent

### Q#3

You are analyzing a proposed project and have compiled the following information:

Should the proposed project be accepted based on its payback period? Why or why not?

A) yes; PB = 2.49 years

B) yes; PB = 2.51 years

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C) no; PB = 2.49 years

D) no; PB = 2.51 years

## Q#4

You are analyzing a proposed project and have compiled the following information:

What is the profitability index of the proposed project?

A) 0.97

B) 0.99

C) 1.01

D) 1.03

## Q#5

The Even Cut Co. is considering opening a new plant to produce lawn mowers. The initial cost of the project is \$6 million. This cost will be depreciated straight-line to a zero book value over the 15-year life of the project. The net income of the project is expected to be \$137,000 a year for the first four years and \$538,000 for years 5 through 15, respectively. What is the average accounting return on this project?

- A) 12.47 percent
- B) 13.17 percent
- C) 14.37 percent**
- D) 15.87 percent

## Q#6

Which one of the following indicates an accept decision for a project?

- A) NPV = -\$318
- B) PI = 0.92

C) IRR = 15.6 percent; Required return = 15 percent

D) Payback = 3.31 years; Required payback = 3 years

Q#7

The point where the net present values of two mutually exclusive projects are equal is referred to as the:

A) profitability point.

B) crossover point.

C) payback point.

D) internal rate of return.

Q#8

For an independent project, the NPV:

A) is the difference between the project's cost and its market value.

- B) generally indicates an accept/reject decision that conflicts with the internal rate of return accept/reject decision.
- C) is the least favored method of project analysis from a finance perspective.
- D) indicates an accept decision when it is negative.

## Q#9

Which one of the following statements correctly applies to the modified internal rate of return (MIRR)?

- A) The MIRR is preferable to the IRR when a project has conventional cash flows.
- B) The MIRR is used to evaluate projects that have negative NPVs.
- C) The MIRR is another means of computing an accounting rate of return.
- D) The MIRR depends upon an external discount rate, an external compounding rate, or both.





## Q#10

Which one of the following statements related to the profitability index (PI) is correct?

- A) PI should be used to determine which one of two mutually exclusive projects should be accepted.
- B) PI is the discount rate that makes the net present value equal zero.
- C) There can be multiple PIs if the cash flows are unconventional.
- D) PI is used to rank positive NPV projects when the available funds are limited**

## Q#1

Treynor Trucking owns some equipment which cost \$459,000 originally. The equipment is classified as 7-year property for MACRS. What will the book value of this equipment be if the firm sells it at the end of year 5?

A) \$61,414

B) \$87,381

**C) \$102,403**

D) \$145,549

## Q#2

A proposed project is expected to increase accounts receivable by \$10,000, decrease inventory by \$4,000, and increase accounts payable by \$6,000. What is the project's initial requirement for net working capital?

A) +\$20,000

**B) \$0**

C) -\$12,000

D) -\$20,000

## Q#3

Last year, Bottlers, Inc. paid cash to purchase land located beside its factory at a price of \$1.89 million. Today, the land has a market value of \$1.95 million. The company is now considering building a new warehouse on that site. The construction cost of the warehouse is estimated at \$1.1 million. In addition, \$450,000 worth of grading, draining, utility work, and paving will be required. What is the initial cash flow of this project?

- A) -\$2.99 million
- B) -\$3.44 million
- C) -\$3.50 million**
- D) -\$1.55 million

## Q#4

You are analyzing a proposed 4-year project. You expect to sell 20,000 units per year at an average selling price of \$5 per unit. The initial cash outlay for fixed assets will be \$120,000. These assets will be depreciated straight-line to a zero book value over the life of the project. The fixed assets will be worthless at the end of the project. Fixed costs are expected to be \$8,000 and variable costs will be \$1.90 per unit. The project requires an initial investment in net working capital of \$10,000 which will be recovered in full at the end of the project's life. What is the project's cash flow for year 4 if the tax rate is 35 percent?

- A) \$24,000
- B) \$34,000
- C) \$45,600
- D) \$55,600**

## Q#5

You purchased some fixed assets six years ago at a cost of \$165,700. You have been depreciating these assets using straight-line depreciation to a zero book value over 10 years. Today, you are selling these assets for \$62,500. What is the aftertax cash flow from this sale if the applicable tax rate is 35 percent?

- A) \$61,177
- B) \$62,500
- C) \$63,823**

D) \$66,280

**Q#6**

You are considering a project that will generate sales of \$89,000, costs of \$56,000, and annual depreciation of \$26,000. What is the value of the operating cash flow if the tax rate is 34 percent?

A) \$28,380

**B) \$30,620**

C) \$47,780

D) \$59,000

**Q#7**

You need a new oven for your bakery. Your current oven is worn out so you are trying to decide which one of two ovens to buy as a replacement. Whichever oven you purchase will be replaced after its useful life. Oven A costs \$25,000 and costs \$3,000 a year to operate over an 8-year life. Oven B costs \$20,000 and costs \$4,500 a year to operate over a 6-year life. Given this information, which one of the following statements is correct if the applicable discount rate is 10 percent?

A) The equivalent annual cost of oven A is -\$7,481.

B) The equivalent annual cost of oven B is -\$8,209.

**C) Oven A lowers the annual cost by \$1,406 as compared to oven B.**

D) Oven B lowers the annual cost by \$1,598 as compared to oven A.

**Q#8**

Which one of the following is a correct method of computing operating cash flow (OCF)? Assume there is no interest expense.

- A)  $\text{EBIT} + \text{Taxes} - \text{Depreciation}$
- B)  $(\text{Sales} - \text{Costs}) (1 - T) + (\text{Depreciation}) (T)$**
- C)  $\text{Net income} - \text{Depreciation}$
- D)  $\text{Sales} - \text{Costs} + \text{Taxes}$

## Q#9

Which one of the following is an example of erosion?

- A) loss of sales due to a temporary ban on curbside parking in front of a retail establishment
- B) a store's decline in wool sweater sales because the store started selling fleece jackets**
- C) declining sales for a fast food restaurant because a competitor opened across the street
- D) declining fast food sales because customers became more health conscious

## Q#10

Which one of the following should be excluded from the cash flows of a project?

- A) sunk costs**
- B) taxes

- C) salvage value
- D) erosion effects

## Q#1

Which one of the following conditions exists at the accounting break-even point?

- A) The payback period equals the life of the project.**
- B) The NPV is negative and exactly equal to the initial cash outlay.
- C) The IRR is -100 percent.
- D) The IRR is equal to the required rate of return.

## Q#2

The lower the degree of operating leverage, the \_\_\_\_\_ the potential danger from \_\_\_\_\_ risk.

- A) greater; capital
- B) greater; forecasting
- C) lower; capital
- D) lower; forecasting**

## Q#3

The analysis of a project that combines scenario and sensitivity analysis is called \_\_\_\_\_ analysis.

- A) simulation**

- B) rationing
- C) break-even
- D) degree of operating leverage (DOL)

## Q#4

Which one of the following determines the level of output required for a project to have a zero net present value?

- A) sensitivity analysis
- B) cash break-even analysis
- C) financial break-even analysis**
- D) scenario analysis

## Q#5

Cotter Pins, Inc. is trying to determine what the selling price of a new product should be if the project is to break-even on a cash basis at a quantity of 1,900 units. The projections include fixed costs of \$3,800, variable costs per unit of \$8.64, and a depreciation expense of \$620. What is the price they should charge?

- A) \$10.64**
- B) \$10.97
- C) \$11.57
- D) \$11.74

## Q#6

Northern Technology manufactures a product with a degree of operating leverage of 2.5. If the fixed costs are \$800 and the depreciation expense is \$430 what is the operating cash flow of this project?

- A) \$246.67
- B) \$320.00
- C) \$533.33
- D) \$820.00

**Q#7**

Gibson Mfg., Inc. is considering the introduction of a new product. Company management has prepared the following estimates related to the project as well as the related range of values, where applicable. The project under consideration has a five-year life and initial costs of \$15,000. Assume the tax rate is 34 percent, there is no salvage value, and the project requires a 12 percent rate of return.

What is the contribution margin under the pessimistic scenario?

- A) \$2.40**
- B) \$3.80
- C) \$4.00
- D) \$5.60



## Q#8

Gibson Mfg., Inc. is considering the introduction of a new product. Company management has prepared the following estimates related to the project as well as the related range of values, where applicable. The project under consideration has a five-year life and initial costs of \$15,000. Assume the tax rate is 34 percent, there is no salvage value, and the project requires a 12 percent rate of return.

What is the projected best-case net income?

A) \$702

B) \$904

C) \$2,687

D) \$3,904

## Q#9

Gibson Mfg., Inc. is considering the introduction of a new product. Company management has prepared the following estimates related to the project as well as the related range of values, where applicable. The project under consideration has a five-year life and initial costs of \$15,000. Assume the tax rate is 34 percent, there is no salvage value, and the project requires a 12 percent rate of return.

What are the projected base-case earnings before interest and taxes?

A) -\$6,616

B) -\$3,000

C) \$1,920

D) \$362

## Q#10

Gibson Mfg., Inc. is considering the introduction of a new product. Company management has prepared the following estimates related to the project as well as the related range of values, where applicable. The project under consideration has a five-year life and initial costs of \$15,000. Assume the tax rate is 34 percent, there is no salvage value, and the project requires a 12 percent rate of return.

What is the projected optimistic net present value?

A) **-\$1,654**

B) -\$1,064

C) \$1,064

D) \$1,654

## Q#1

Over the period 1926-2007, small-company stocks produced an average annual return of 17.1 percent with a standard deviation of 32.6 percent. Based on this information, what is the range of returns an investor can expect to earn in any one year given a 95 percent probability range?

A) -48.1 to 82.3 percent

**B) -36.2 to 70.5 percent**

C) -80.7 to 114.9 percent

D) -15.5 to 49.7 percent

## Q#2

Over the period 1926-2007, intermediate-term government bonds had an average annual return of 5.5 percent, U.S. Treasury bills returned 3.8 percent, and inflation averaged 3.1 percent. What was the average risk premium on intermediate-term government bonds for this time period?

A) 0.07 percent

B) 1.7 percent

C) 2.4 percent

D) 5.5 percent

## Q#3

Which one of the following statements is correct?

A) The standard deviation of the returns on large- company stocks exceeded the standard deviation of the returns on small-company stocks for the period 1926-2007.

B) For the period of 1926-2007, the average annual rate of inflation exceeded the average annual return on U.S. Treasury bills.

C) The standard deviation of the returns on U.S. Treasury bills was zero percent for the period 1926-2007.

D) The frequency distribution of the returns on large- company stocks is wider than the frequency distribution of the returns on long-term corporate bonds for the period 1926-2007.

## Q#4

Which one of the following best describes the information reflected in market prices if the financial markets are semistrong form efficient?

A) only historical price information

B) all private information

C) all public information

D) all information of any kind

## Q#5

Over a 25-year period, a security had an arithmetic average return of 9.8 percent and a geometric average return of 8.7 percent. Based on Blume's formula, what is the projected average rate of return on this security for the next 5 years?

A) 8.27 percent

B) 8.53 percent

C) 8.88 percent

D) 9.62 percent

## Q#6

One year ago, you purchased a stock at a price of \$36.24 a share. You received an annual dividend of \$1.80 a share and sold the stock today for \$32.12 a share. What was your capital gains rate of return?

A) -11.28 percent

B) -11.37 percent

C) -12.76 percent

D) -12.83 percent

## Q#7

You purchased 100 shares of Plum's, Inc. stock at a price of \$35.87 a share exactly one year ago. You have received dividends totaling \$1.05 a share. Today, you sold your shares at a price of \$46.26 a share. What is your total dollar return on this investment?

- A) \$10.39
- B) \$11.44
- C) \$1,039
- D) \$1,144**

## Q#8

A stock has produced annual returns of 11 percent, 15 percent, -6 percent, and 4 percent over the past four years, respectively. What is the 68 percent probability range of returns?

- A) -2.8 to 14.8 percent
- B) -12.4 to 24.4 percent
- C) -9.9 to 21.9 percent
- D) -3.2 to 15.2 percent**

## Q#9

A stock has produced average annual returns of 7 percent, 12 percent, 19 percent, -8 percent, and 5 percent over the past five years. What is the geometric average rate of return?

- A) 6.62 percent**
- B) 7.00 percent
- C) 10.10 percent
- D) 12.87 percent

## Q#10

You previously owned 200 shares of AMG Co. stock. This stock earned a dividend yield of 3.75 percent and a total return of 10.74 percent. If you purchased the stock at \$43.90, approximately what price did you receive when you sold it one year later?

- A) \$45.55
- B) \$46.97**
- C) \$48.62
- D) \$50.05

## Q#1

Which one of the following is another name for market risk?

- A) diversifiable
- B) systematic**
- C) total
- D) unique

## Q#2

Which one of the following best describes how an underpriced stock will plot on a security market line graph?

- A) to the right of the overall market
- B) to the left of the overall market
- C) above the security market line**
- D) below the security market line

## Q#3

Diversification reduces which type of risk?

- A) market
- B) total
- C) asset specific**
- D) systematic

## Q#4

Which one of the following statements is correct?

- A) Beta measures total risk.
- B) The higher the beta, the lower the expected rate of return.
- C) The standard deviation of a portfolio could be lower than lowest standard deviation of any one security held within the portfolio.**
- D) Correctly-priced securities will have a reward-to-risk ratio of 1.0.

## Q#5

U.S. Treasury bills are yielding 4.6 percent while the market is returning 14.8 percent. What is the expected return on a security that has a beta of 0.86?

- A) 8.92 percent
- B) 12.49 percent
- C) 9.13 percent
- D) 13.37 percent**



## Q#6

Stock A has a beta of 1.52 and a return of 18.9 percent. Stock B has a beta of 2.26 and a return of 24.3 percent. What is the risk-free rate of return if both stock A and stock B are correctly priced?

- A) 4.39 percent
- B) 3.40 percent
- C) 6.24 percent
- D) 7.81 percent**

## Q#7

A portfolio is equally comprised of five stocks. The betas of four of those stocks are 0.82, 1.16, 1.09, and 1.78. What is the beta of the fifth stock if the portfolio beta is equal to the market beta?

- A) -0.05
- B) 0.15**
- C) 0.25
- D) 0.38

## Q#8

A portfolio consists of the following: \$4,000 of stock A with beta of 1.2, \$3,000 of stock B with beta of 1.41, and \$8,000 of U.S. Treasury bills. What is the portfolio beta?

- A) 0.55
- B) 0.60**

- C) 0.71
- D) 1.31

## Q#9

A portfolio consists of 60 percent of stock A and 40 percent stock B. What is the expected return on this portfolio given the following information?

- A) 3.83 percent
- B) 0.54 percent
- C) 5.29 percent
- D) 4.08 percent

## Q#10

A portfolio consists of 30 percent of stock A and 70 percent of stock B. What is the standard deviation of this portfolio given the following information?

- A) 9.92 percent
- B) 10.64 percent**
- C) 11.38 percent
- D) 9.79 percent

## Q#1

Alpha Enterprises is considering a new project. Alpha's management has determined that the required return for this new project should be based on the weighted average cost of capital for Beta Co. What approach did Alpha's managers use to determine the project's required rate of return?

- A) subjective
- B) objective
- C) pure play**
- D) alternate play

## Q#2

Which one of the following will increase a firm's aftertax cost of debt financing?

- A) decrease in the corporate tax rate**
- B) increase in the dividend yield
- C) increase in a bond's current market price

- D) decrease in the market rate of interest

## Q#3

The 7 percent preferred stock for Madden, Inc. is currently selling for \$68 a share. What is the cost of preferred stock?

- A) 7.00 percent  
B) 10.29 percent  
C) 4.76 percent  
D) 7.27 percent

## Q#4

Kaylor & Stewart issued 20-year bonds 3 years ago. The bonds have a face value of \$1,000, a market price of \$989, a 6 percent coupon, and pay interest semi-annually. The firm's tax rate is 34 percent. What is the aftertax cost of debt?

- A) 3.92 percent  
B) 4.03 percent  
C) 4.11 percent  
D) 4.18 percent

## Q#5

Pete's Garden House has a cost of equity of 15.6 percent, an aftertax cost of debt of 7.1 percent, a debt-equity ratio of 0.45, and a tax rate of 35 percent. What is the firm's weighted average cost of capital?

- A) 12.19 percent
- B) 12.27 percent
- C) 12.77 percent
- D) 12.96 percent**

## Q#6

Lester's Feed Mill just paid its annual dividend of \$1.34 per share. The firm has a policy of increasing its dividend by 2.5 percent annually. What is the cost of equity if the firm's stock is currently selling for \$22.82 per share?

- A) 8.26 percent
- B) 8.37 percent
- C) 8.52 percent**
- D) 8.61 percent

## Q#7

Traveler's Rest has 12,000 shares of common stock outstanding at a market price of \$31.16 a share, 4,500 shares of preferred stock outstanding at \$45 a share, and 500 bonds outstanding that are selling for 89 percent of their \$1,000 face value. The firm's pre-tax cost of debt is 8.9 percent. The cost of equity is 14.7 percent and the cost of preferred is 8.8 percent. What is the firm's weighted average cost of capital if the tax rate is 34 percent?

- A) 8.47 percent
- B) 9.69 percent**
- C) 10.37 percent
- D) 10.92 percent

## Q#8

Charleston Mills has a debt-equity ratio of 0.62 and a tax rate of 35 percent. The firm has a \$500,000 bond issue outstanding that is currently valued at 94 percent of par value. The bond carries a 7 percent, semiannual coupon and matures in 14.5 years. The common stock is selling for \$56 a share and has a beta of 1.08. The firm is analyzing a project that it feels is riskier than the company's current operations and thus the firm's managers have assigned an adjustment factor of 1.5 percent to the project. What is the project's required rate of return if the market rate is 10.8 percent and Treasury bills are yielding 2.7 percent?

- A) 8.98 percent
- B) 9.24 percent
- C) 9.59 percent
- D) 10.48 percent**

## Q#9

A firm has a cost of equity of 14 percent, a cost of preferred of 9.5 percent, and a pre-tax cost of debt of 8.7 percent. The capital structure of the firm is 55 percent common, 15 percent preferred, and 30 percent debt. The tax rate is 34 percent. What is the firm's weighted average cost of capital?

- A) 9.88 percent
- B) 10.85 percent**
- C) 11.39 percent
- D) 11.74 percent

## Q#10

Jasper's, Inc. is expected to pay an annual dividend of \$1.21 per share next year. This dividend is expected to increase by 3.5 percent annually. Jasper's also pays a 6 percent, annual coupon on its outstanding bonds. These bonds mature in 12.5 years and have a face value of \$1,000. The firm's stock has a beta of 1.38 and a

market price of \$42.60 a share. The bonds are priced at \$1,064 each. The market risk premium is 9.5 percent, the risk-free rate is 3.7 percent, and the tax rate is 32 percent. What is the firm's weighted average cost of capital if its debt-equity ratio is 0.36?

- A) 9.46 percent
- B) 9.58 percent
- C) 9.64 percent
- D) 9.69 percent

## Q#1

The federal regulations that apply to all new interstate security issues are set forth in the:

- A) Securities Law of 1929.
- B) Securities Act of 1933.
- C) Securities Exchange Act of 1934.
- D) NASD Guidelines for the Financial Markets.

## Q#2

The newspaper advertisement of a new securities issue is called a:

- A) letter of comment.
- B) registration statement.
- C) prospectus.
- D) tombstone.

## Q#3

Circus Town is offering 700 shares of stock in a Dutch auction. The bids include:

How much cash will Circus Town receive from this stock offering? Ignore all costs.

A) \$9,800

B) \$10,700

C) \$9,100

D) \$10,300

## Q#4

Internet Ideas, Inc. is offering 20,000 shares in an initial public offering. The underwriters have agreed upon a best efforts offering with an offer price of \$27 and a 5 percent spread. The underwriters were able to sell 18,500 shares to the general public. The stock opened at a price of \$31 a share on its first day of trading. How much did Internet Ideas, Inc. receive from this offering?

A) \$474,525



- B) \$499,500
- C) \$513,000
- D) \$589,000

## Q#5

The Computer Co. wants to raise \$4 million through a rights offering. Currently, the company has 1.5 million shares outstanding and plans on issuing one right for each share. The current market price is \$50 and the subscription price is \$40. What do shareholders have to submit to receive one new share of stock under this rights offering?

- A) 15 rights + \$40**
- B) 15 rights + \$50
- C) 18.75 rights + \$40
- D) 18.75 rights + \$50

## Q#6

TES, Inc. currently has 700,000 shares of stock outstanding at a market price of \$35 a share. The company wants to raise \$3 million in a rights offering. The subscription price is \$30 a share. One right will be granted for every share of outstanding stock. What is the value of one right?

- A) \$0.92
- B) \$0.38
- C) \$0.70
- D) \$0.63**

## Q#7

You currently own 8 percent of the 200,000 shares of outstanding stock in Jones, Inc. The firm has announced it is offering an additional 40,000 shares to the public. What will your new ownership position be if you opt to not participate in the additional stock offering? Assume the issue is fully subscribed.

- A) 5.83 percent
- B) 6.33 percent
- C) 6.54 percent
- D) 6.67 percent**

## Q#8

The decline in the price of the currently outstanding shares of stock that frequently occurs when a new issue of stock is announced is referred to as the:

- A) gross spread.
- B) underpricing.
- C) abnormal return.**
- D) indirect expense.

## Q#9

Which one of the following allows the underwriters to purchase additional shares at the offer price to cover overallocments?

- A) Green Shoe option**
- B) Red Herring statement
- C) White Knight provision
- D) Small-issues exemption

## Q#10

The ex-rights date is defined as \_\_\_\_\_ trading days prior to the holder-of-record date.

- A) 1
- B) 2**
- C) 3
- D) 5

## Q#1

M&M Proposition I with taxes implies that a firm's weighted average cost of capital:

- A) remains constant regardless of a firm's debt-equity ratio.
- B) increases as the debt-equity ratio increases.
- C) decreases as the debt-equity ratio increases.**
- D) varies independently of a firm's debt-equity ratio.

## Q#2

Homemade leverage refers to the:

**A) ability of an individual investor to control the amount of leverage to which he or she is exposed.**

- B) ability of a firm to self-determine the amount of leverage it prefers.

- C) amount of debt a small firm arranges with its local bank.
- D) ability of a business to borrow money from an individual investor.

## Q#3

The static theory advocates borrowing to the point where:

- A) the pre-tax cost of debt is equal to the cost of equity.
- B) the cost of equity is equal to the interest tax shield.
- C) the tax benefit from debt is equal to the cost of the increased probability of financial distress.**
- D) the debt-equity ratio equals 1.0.

## Q#4

The value of an unlevered firm is equal to:

- A)  $[EBIT + (1 - TC)] / RU$ .
- B)  $[EBIT \times (1 - TC)] / RU$ .**
- C)  $VL + TC \times D$ .
- D)  $VL \times (TC / D)$ .

## Q#5

Gilbert & Sons is a levered firm. It has 300,000 shares of stock outstanding with a market price of \$32 per share. The company also has \$6.6 million of debt outstanding that sells at par. The pre-tax cost of debt is 9 percent and the unlevered cost of capital is 12 percent. What is the cost of equity if the tax rate is 35 percent?

- A) 12.00 percent
- B) 12.79 percent
- C) 13.34 percent**
- D) 14.84 percent

## Q#6

Best Foods, Inc. has an unlevered cost of capital of 12 percent. The company generates earnings before interest and taxes of \$6,000 per year and has a tax rate of 35 percent. What will the value of the firm be if the firm adds \$20,000 of debt to its capital structure?

- A) \$32,500
- B) \$39,500**
- C) \$45,500
- D) \$57,000

## Q#7

The order of claims in a bankruptcy is set forth in the:

- A) Bankruptcy Act of 1932.

- B) absolute priority rule.
- C) Securities Act of 1933.
- D) initial bankruptcy filing.

## Q#8

Your firm has 5,000 bonds outstanding with a face value of \$1,000 each. These bonds have a 9 percent coupon, pay interest annually, and are currently selling for 99 percent of par value. What is the present value of the interest tax shield if the tax rate is 34 percent?

- A) \$44,550
- B) \$45,000
- C) \$1,683,000
- D) \$1,700,000

## Q#9

Blue Ridge Tours has a cost of equity of 14.28 percent and a pre-tax cost of debt of 8.1 percent. The debt-equity ratio is 0.60 and the tax rate is 34 percent. What is the firm's unlevered cost of capital?

- A) 9.8 percent
- B) 12.21 percent
- C) 12.53 percent
- D) 13.07 percent

## Q#10

The Plains Dealer has a cost of equity of 15.2 percent and a pre-tax cost of debt of 7.6 percent. The required return on the assets is 12.6 percent. What is the firm's debt-equity ratio base on M&M II without taxes?

- A) 0.38
- B) 0.41
- C) 0.52**
- D) 0.63

## Q#1

Berkley Industrial Supply declared a dividend on Monday, August 3 to holders of record on Monday, August 17. The dividend is payable on Friday, September 4. The last day you can purchase shares of this stock and receive the September 4 dividend is:

- A) August 12.**
- B) August 13.
- C) September 1.
- D) September 2.

## Q#2

Which one of the following statements is correct?

- A) A cash dividend has no effect on the market value per share.
- B) A stock repurchase increases the market value per share.
- C) Stock repurchases are more tax advantageous than are cash dividends.**

- D) A stock repurchase increases the book value of shareholders' equity.

## Q#3

Which type of transaction reduces the number of shares of stock outstanding but does not affect the value of owners' equity?

- A) stock dividend
- B) rights offering
- C) stock split
- D) reverse stock split**

## Q#4

Which one of the following dividend types represents a truly unusual, one-time dividend payment?

- A) special**
- B) regular
- C) homemade
- D) extra cash

## Q#5

Which one of the following favors a high dividend payout?

- A) flotation costs
- B) dividend restrictions
- C) high personal tax rate on dividend income



**D) uncertainty resolution**

## Q#6

Angie's just declared a 5 percent (small) stock dividend. Prior to the dividend, the stock had a \$1 par value per share, a \$15 book value per share and a \$15 market value per share. As a result of this dividend, the:

- A) common stock account will remain constant.
- B) common stock account will decrease in value.
- C) retained earnings account will increase in value.
- D) capital in excess of par value account will increase in value.**

## Q#7

Which one of the following values will not change when a firm declares a large stock dividend?

- A) common stock account balance
- B) par value per share**
- C) market price per share
- D) retained earnings account balance

## Q#8

The common stock of Hoestetler Supply is currently selling for \$8 a share. The company just declared a 2-for-5 reverse stock split. As a result of the split, the market price per share will be \_\_\_\_\_, all else constant.

- A) \$16

B) \$20

C) \$32

D) \$40

## Q#9

BLK, Inc. has 12,000 shares of stock outstanding with a market price per share of \$60. The net aftertax earnings of the firm are \$45,000. The firm has just declared a 3-for-1 stock split. What will the price-earnings ratio be after the stock split?

A) 5.33

B) 12.50

C) 16.00

D) 48.00

## Q#10

Smythe Tool has 18,000 shares of stock outstanding with a par value of \$1 per share and a market value of \$41 per share. The company just declared a 2-for-1 stock split. As a result of this split:

A) the total value of the owners' equity will be cut in half.

B) the number of shares outstanding will increase to 36,000.

C) market price per share will increase to \$82 a share.

D) par value per share will remain at \$1 per share.

## Q#1

An increase in which one of the following is a use of cash?

- A) accounts payable
- B) long-term debt
- C) inventory**
- D) owners' equity

## Q#2

A firm has an accounts payable period of 54 days, an inventory period of 69 days, and an accounts receivable period of 37 days. What is the length of the cash cycle?

- A) 54 days
- B) 52 days**
- C) 106 days
- D) 86 days

## Q#3

The Corner Market has sales of \$898,000 and cost of goods sold equal to 70 percent of sales. The beginning inventory is \$64,000 and the ending inventory is \$71,000. What is the length of the inventory period?

- A) 39.2 days**
- B) 13.3 days
- C) 27.4 days
- D) 9.3 days

## Q#4

All else equal, which one of the following will decrease the operating cycle?

- A) decrease in the cash cycle
- B) decrease in the inventory turnover rate
- C) increase in the accounts receivable turnover rate**
- D) increase in the payables turnover rate

## Q#5

Money deposited in a bank in a low-interest or non-interest-bearing account to fulfill a requirement in a loan agreement is called a:

- A) compensating balance.**
- B) credit deposit.
- C) line of credit.
- D) cash reserve.

## Q#6

A restrictive short-term financial policy:

- A) results in relatively low inventory levels.**
- B) involves more long-term financing than a flexible policy does.
- C) results in high accounts receivable balances.
- D) has a relatively high ratio of current assets to sales.

## Q#7

Tri-State Movers has projected quarterly sales of \$1,800, \$2,400, \$2,800, and \$1,200 for quarters one through four, respectively. The accounts receivable period is 30

days. How much will the firm collect in Quarter 3? Assume each quarter has 90 days.

- A) \$2,600
- B) \$2,400
- C) \$2,533
- D) \$2,667**

## Q#8

A firm has projected monthly sales of \$800, \$900, \$1,100, and \$1,400 for the months of January through April, respectively. The cost of goods sold is 60 percent of the selling price and the accounts payable period is 60 days. Goods are purchased one month prior to the month of sale. What is the amount of the March cash disbursements?

- A) \$480
- B) \$520
- C) \$540**
- D) \$600

## Q#9

Waterfront Yachts maintains a large inventory of unique yachts for sale to discriminating buyers. Which one of the following is the most appropriate form of financing this firm's inventory?

- A) commercial paper
- B) trust receipt**
- C) field warehousing

- D) blanket inventory lien

## Q#10

Russell's of Townville needs to borrow \$48,000 for one year. The bank requires a 5 percent compensating balance on any amount borrowed and an annual interest rate of 9 percent. What is the effective interest rate on this loan?

- A) 9.00 percent
- B) 9.29 percent
- C) 9.47 percent**
- D) 9.56 percent

## Q#1

Which one of the following is the motive to hold cash for activities such as making bargain purchases?

- A) float
- B) transaction
- C) precautionary
- D) speculative**

## Q#2

Which one of the following represents the present value of eliminating float?

- A) one day's float
- B) daily float / risk-free rate
- C) total float**

- D) average daily float

## Q#3

Which one of the following will decrease collection float?

- A) issuing checks to your suppliers from a remote location
- B) installing a lockbox system for customer payments**
- C) paying your suppliers electronically
- D) increasing the processing delay

## Q#4

Which one of the following statements is correct?

- A) The Check Clearing Act for the 21st Century increases disbursement float.
- B) Providing early payment discounts to customers increases collection float.
- C) Payroll checking accounts always require a safety stock.
- D) Cash concentration accounts tend to simplify cash management systems.**

## Q#5

Which one of the following affects your disbursement float?

- A) time it takes for your bank to make funds available once you make a deposit
- B) time for your staff to process and deposit checks
- C) time for your customers' checks to reach your office once they are mailed

D) time for your staff to verify and pay invoices

Q#6

When you reconciled your checkbook to the bank, you had outstanding deposits of \$7,219 and outstanding checks of \$4,511. Your adjusted check book balance is \$2,029. What is the amount of the collection float?

A) \$2,029

B) \$4,737

C) \$4,511

D) \$7,219

Q#7

A firm has only four customers. Shown below is the average amount of the monthly check received from each customer along with the average collection delay. What is the amount of the average daily receipts assuming that each month has 30 days?

A) \$7,933

B) \$6,667

C) \$15,867



D) \$59,500

## Q#8

On average, High Tower Insurance receives 75 checks each day. The average amount of each check is \$1,300. The firm is considering installing a lockbox system which will reduce the average collection time by 3 days. The bank will charge \$0.25 a check for the lockbox arrangement. The daily interest rate on Treasury bills is 0.01 percent. What is the net present value of the lockbox arrangement?

A) \$97,500

**B) \$105,000**

C) \$112,500

D) \$95,000

## Q#9

Burlington Company receives an average of 426 checks each day that have an average value of \$420 per check. If the firm decides to install a lockbox system it can reduce the average collection time by 2 days. The cost of the lockbox system is \$0.32 per check. The daily interest rate on Treasury bills is 0.0125 percent. What is the daily cost of the lockbox system?

A) \$45

B) \$134

**C) \$136**

D) \$273

## Q#10

You are analyzing a firm that receives an average of 330 checks each day with an average amount of \$49 per check. These checks clear the bank on average in 1.38 days. The applicable daily interest rate is 0.015 percent. What is the present value of the float assuming that each month has 30 days?

- A) \$9,200
- B) \$3,593
- C) \$19,240
- D) \$22,315**

## Q#1

The conditions under which a firm sells its goods for cash or credit are called:

- A) the terms of sale.**
- B) credit analysis.
- C) credit scoring.
- D) the invoice.

## Q#2

Which one of the following factors tends to decrease the credit period for a sale?

- A) new product
- B) low credit risk buyer
- C) highly competitive market
- D) inexpensive product**

## Q#3

Credit terms of 2/5, net 15 means that a customer:

- A) receives a 2/5 percent discount if the invoice is paid within 15 days.
- B) is entitled to a 2 percent discount if the invoice is paid within 5 days.**
- C) must pay the invoice in full within 5 days and the invoice is considered delinquent after 15 days.
- D) must pay in full within 10 days

## Q#4

The optimal amount of credit is determined by equating which of the following costs?

- A) variable; fixed
- B) carrying; opportunity**
- C) marginal; total
- D) marginal; opportunity

## Q#5

A set of tires represents which type of inventory for Toyota?

- A) raw materials**

- B) floor plan
- C) work-in-progress
- D) finished goods

## Q#6

All of the following are included in the 5 Cs of Credit except:

- A) conditions.
- B) collateral.
- C) character.
- D) credit score.**

## Q#7

Carlisle Motors sells 2,600 electric motors each year. The fixed costs per order are \$189 and the average variable cost per motor is \$897. The carrying cost per motor is \$22. What is the economic order quantity?

- A) 211 units**
- B) 223 units
- C) 231 units
- D) 236 units

## Q#8

Wellington United has current monthly sales of 311 units at an average price of \$69 a unit. The variable cost per unit is \$47 and the monthly interest rate is 0.8 percent. Currently, the firm has a cash only sales policy. How many additional units per month must the company sell to break even on a switch to a net 30 credit policy?

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- A) 6.5 units
- B) 7.0 units
- C) 7.5 units
- D) 7.9 units**

## Q#9

Your company may have the opportunity to make a one-time sale provided it grants a new customer one month's credit. The sales price of the item is \$129, the variable cost is \$74, and the relevant interest rate is 0.9 percent per month. What is the net present value of this sale if there is a 25 percent chance the customer will default on payment?

- A) -\$32.75
- B) \$40.39
- C) \$21.89**
- D) \$14.76

## Q#10

Which one of the following inventory systems involves the separation of inventory items into various categories based solely on the cost per unit?

- A) EOQ
- B) ABC**
- C) JIT
- D) MRP

## Q#1

International bonds issued in multiple countries but denominated in a single currency are called:

- A) Eurobonds.
- B) foreign bonds.
- C) gilts.
- D) American Depositary Receipts

## Q#2

Agreements to exchange two securities or currencies are called:

- A) cross-rates.
- B) ADRs.
- C) swaps.
- D) gilts.

## Q#3

The notion that a commodity costs the same regardless of where it is purchased or what currency is used to pay for the purchase is known as:

- A) the international Fisher effect.
- B) the home currency approach.
- C) relative purchasing power parity.
- D) absolute purchasing power parity.

## Q#4

Interest rate parity is the condition that states that the interest rate differential between two countries is equal to the percentage difference between the:

- A) the real rates in each country.
- B) inflation rates in each country.
- C) spot exchange rates in each country.
- D) forward exchange rate and the spot exchange rate.**

## Q#5

The U.S. dollar (\$) equivalent of the Japanese yen (¥) is 0.01015. The U.S. dollar equivalent of the Australian dollar (A\$) is 0.67069. Which one of the following statements is correct given this information?

- A) \$750 is worth about ¥7.62.
- B) \$300 is worth about A\$201.21.
- C) ¥400 is worth about \$4.06.**
- D) A\$200 is worth about \$298.20.

## Q#6

You can exchange \$1 (US dollar) for either C\$1.21 (Canadian dollar) or €0.78 (Euro). Given these rates, which one of the following correctly defines the cross-rate between the Canadian dollar and the Euro?

- A) C\$1 = €1.551
- B) C\$1 = €1.628
- C) €1 = C\$1.628

D) €1 = C\$1.551

Q#7

The current spot rate between the U.S. and the U.K. is \$1.00 = £0.62. If absolute purchasing power parity holds, what is the price per bushel of potatoes in the U.S. given that the same bushel costs £3.30 in the U.K.?

A) \$2.05

B) \$2.38

C) \$5.32

D) \$5.46

Q#8

The current spot rate on the Euro is €0.7836 per \$1. U.S. Treasury bills are yielding 2.5 percent. The rate on a risk-free European asset is 3 percent. What is the approximate 2-year forward rate if interest rate parity exists?

A) €0.7915 = \$1

B) €0.7874 = \$1

C) €0.7072 = \$1

D) €0.7319 = \$1

Q#9

The spot rate between the Mexican peso and the U.S. dollar is Ps12.88 per \$1. The expected inflation rate in the U.S. is 1.6 percent and the U.S. Treasury bill is yielding 3.4 percent. The risk-free rate of return in Mexico is 4.2 percent. What is the rate of inflation in Mexico?



- A) 1.8 percent
- B) 2.2 percent
- C) 2.4 percent**
- D) 2.8 percent

## Q#10

Your company is considering an expansion project in India. The project has an initial cost of Rs 1,250,000. The project will return Rs 400,000 a year for 5 years. The applicable discount rate in India is 8 percent. The inflation rate in the U.S. is 2 percent while it is 5 percent in India. The spot rate is Rs 49.46 per \$1. What is the net present value of this project in dollars?

- A) \$5,270
- B) \$5,491
- C) \$6,294
- D) \$7,017**

## Q#1

Suzie is the manager of a small retail store. She thinks that the store should expand in size and so is currently considering doing so. Suzie seems to prefer discussing her plans with those employees who agree with her idea while tending to ignore those employees who disagree with her. Suzie can best be used as an example of which one of the following?

- A) overoptimism
- B) overconfidence
- C) frame dependence
- D) confirmation bias**

## Q#2

Bill loves to day trade stocks. However, while observing his trades, you noticed that he appears unaffected whenever he loses any of his prior gains but tends to pout when he loses any of the money he earned from his regular job. Bill can best be used to illustrate of which one of the following?

- A) heuristics
- B) house money**
- C) clustering
- D) confirmation bias

## Q#3

Kate is a marketing manager. She has recently noticed that any men's shirts that she displays sell faster if the displayed shirt is blue. Thus, she has decided that all displays of clothing, men's, women's and children's, should feature blue items. Which one of the following is most likely affecting this decision by Kate?

- A) frame dependence
- B) randomness
- C) affect heuristic
- D) representative heuristic**

## Q#4

June tends to believe that others agree with her opinions even when no one has expressed their agreement. June can best be used as an example of which one of the following?

- A) false consensus**
- B) anchoring

- C) recency bias
- D) availability bias

## Q#5

Which one of the following tends to encourage arbitrage trading rather than hindering it?

- A) firm-specific risk
- B) well-capitalized traders**
- C) noise traders
- D) costs of implementation

## Q#6

The stock market in 1929 is the best example of which one of the following?

- A) bubble
- B) GEF
- C) crash**
- D) clustering illusion

## Q#7

The performance of professional money managers over time tends to support the argument that financial markets tend to be:

- A) efficient.**
- B) inefficient.

- C) heuristic.
- D) non-heuristic.

## Q#8

Jeff never wants to make a decision as he's always afraid that he might later wish that he had made a different choice. Jeff suffers most from which one of the following?

- A) self-attribution bias
- B) myopic loss aversion
- C) regret aversion
- D) money illusion

## Q#9

Assume Kris has two choices. She can either keep a \$1 bill or buy a lottery ticket that costs \$1. The grand prize for the lottery drawing is \$1 million. Kris does not know what her chances are for winning the lottery and thus, she opts to keep the \$1 bill. Which one of the following best applies to Kris?

- A) aversion to ambiguity
- B) law of small numbers
- C) availability bias
- D) gambler's fallacy

## Q#10

Ted and Fred both own very similar homes on the same street. Ted feels that his house is worth \$200,000 while Fred's house is only worth \$175,000. Fred feels exactly the opposite. Both Ted and Fred display which one of the following behaviors?

- A) regret aversion
- B) endowment effect**
- C) money illusion
- D) house money

## Q#1

A financial asset that represents a claim to another financial asset is called a:

- A) hedged asset.
- B) subordinated asset.
- C) dual security.
- D) derivative security.**

## Q#2

The primary purpose of a hedge is to:

- A) reduce rate or price fluctuations.**
- B) lock in a future exchange rate.
- C) increase the potential maximum rate of return.
- D) guarantee interest rate parity.

## Q#3

The short-run financial risk related to the need to buy or sell at uncertain prices in the near future is referred to as:

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- A) economic exposure.
- B) transactions exposure.**
- C) exchange exposure.
- D) demand and supply exposure.

## Q#4

Which one of the following statements is correct?

- A) Marking-to-market is the term that applies to the daily resettlement feature found in all forward contracts.
- B) A futures contract is exactly the same as a forward contract.
- C) Using a contract on a related, but not identical, asset as a means of hedging is called cross-rating.
- D) The gains or losses on a futures contract are realized on a daily basis.**

## Q#5

Which one of the following creates an obligation to sell?

- A) buying a call
- B) buying a put
- C) writing a call**

D) writing a put

## Q#6

Which of the following positions will be profitable if the price of ABC stock rises?

- I. buying ABC stock
- II. buying a put on ABC stock
- III. writing a call on ABC stock
- IV. buying a call on ABC stock

A) I and III only

B) II and IV only

C) I and IV only

D) I, II, and III only

## Q#7

An agreement between two firms to exchange specified cash flows at specified intervals in the future is called a:

A) swap contract.

B) futures contract.

C) multiple exchange.

D) multiple put.

## Q#8

Alpha Co. can borrow at 8 percent fixed or prime plus 2 percent. Beta Co. can borrow at 8.5 percent fixed or prime plus 1 percent. Which one of the following swaps is most apt to occur if Alpha Co. wants a variable rate and Beta Co. wants a fixed rate?

- A) 8 percent fixed for prime plus 2 percent
- B) 8.5 percent fixed for prime plus 1 percent
- C) 8.25 percent fixed for prime plus 1.5 percent
- D) 8.25 percent fixed for prime plus 0.5 percent

## Q#9

Use this information to answer question.

What is the closing value on one oats May futures contract?

- A) \$21,463
- B) \$19,678
- C) \$20,200
- D) \$21,550



## Q#10

Use this information to answer question.

Last week, you purchased three May futures contracts on oats at a quoted price of 428'4. What is your total profit or loss on this position as of today's close?

A) -\$3,675

B) -\$3,660

C) -\$3,550

D) -\$3,475

## Q#1

You would like to have the option to buy 100 shares of TC Toys stock at \$45 a share anytime during the next three months. You should buy a (an):

A) American call.

B) American put.

- C) European call.
- D) European put.

## Q#2

Last month, you purchased a put option on Deltona stock with an exercise price of \$30 per share and an option premium of \$0.20 per share. Today, the price of Western Wear stock is \$29.60 per share. What is the current intrinsic value of your option per share?

- A) \$0
- B) \$0.20
- C) \$0.40**
- D) \$0.60

## Q#3

You purchased two call option contracts on Webster stock at a time when the stock was selling for \$31.20 a share and the option premium was \$1.60 per share. The exercise price is \$30 per share. What will be your total profit or loss if the price of Webster stock is \$30.40 per share when the options expire?

- A) -\$240**
- B) -\$160
- C) -\$280
- D) -\$320

## Q#4

If you sell (write) an American put option contract you have the:

A) right to sell 100 shares of stock at a specified price during a specified period of time.

B) obligation to sell 100 shares of stock if the option is exercised.

C) right to buy 100 shares of stock at a specified price during a specified period of time.

**D) obligation to buy 100 shares of stock if the option is exercised.**

## Q#5

Which of the following are basically call options?

I. employee stock option

II. warrant

III. debt in a leveraged firm

IV. equity in a leveraged firm

A) I and III only

B) II and IV only

C) I and II only

**D) I, II, and IV only**

## Q#6

The October 25 put on Langley Industries, Inc. stock is quoted at \$1.10 per share. The stock has a current market price of \$24.50 per share. What is the current intrinsic value per share of this put?

- A) -\$1.10
- B) -\$0.60
- C) \$0
- D) \$0.50**

## Q#7

You purchased two call option contracts on Neiger Mills, Inc. stock at an option premium of \$0.30 per share and an exercise price of \$32.50 per share. What will be your total profit or loss on this investment on the expiration date if Neiger Mills, Inc. stock is valued at \$31.30 per share at that time? Ignore trading costs and taxes.

- A) -\$60**
- B) -\$30
- C) \$0
- D) \$180

## Q#8

Currently, the U.S. Treasury bill is yielding 3.6 percent while the common stock of TL Movers, Inc. is selling for \$31.20 a share. What is the current value of a one-year call option on this stock if the exercise price of the option is \$30.00 per share?

- A) \$0
- B) \$1.20
- C) \$1.24

D) \$2.24

## Q#9

The assets of Newmont Stores are currently valued at \$410,000. The assets are expected to be worth either \$375,000 or \$450,000 one year from now. The company has a pure discount loan outstanding that matures in one year. The face value of the loan is \$400,000. The risk-free rate of return is 4 percent and the inflation rate is 2.5 percent. What is the value of the equity in Newmont Stores?

- A) \$9,615
- B) \$25,385
- C) \$32,949
- D) \$36,891

## Q#10

If you commence a project today, you will have initial costs of \$51,000 and annual cash inflows of \$17,000 for 4 years. If you wait until next year to start this project, your initial costs will increase to \$55,000 and the annual cash inflow for each of the 4 years will be \$19,000. What is the value of the option to wait if the applicable discount rate is 12 percent?

- A) \$1,316
- B) \$1,784
- C) \$2,611
- D) \$3,571

## Q#1

The benefits of owning a share of stock and a put option can be duplicated by:

A) investing in a risk-free security and buying a call option.

B) writing a put option and investing in a risk-free security.

C) selling a share of stock and writing a call option.

D) selling both a put option and a risk-free security.

Q#2

Which one of the following statements is correct?

A) An American style option is worth more than a comparable European style option.

B) The sensitivity of an option's value to the passage of time is called the option's vega.

C) The value of an option is equal to the option's intrinsic value minus the time premium.

D) Increasing the risk-free rate has a negative impact on call values.

Q#3

Increasing which one of the following will decrease the value of a put?

A) strike price

B) standard deviation of the returns on the stock

C) time to expiration

D) risk-free rate

Q#4

Which one of the following statements is correct?

- A) Rho measures an option's value relative to a small price change in the underlying asset.
- B) The Black-Scholes option pricing model applies only to American options.
- C) European options can only be exercised on the expiration date.
- D) All five factors in the Black-Scholes model can be directly observed.

Q#5

Which one of the following relates the change in the value of a firm's equity to the change in the value of the firm's assets?

- A) vega
- B) rho
- C) delta
- D) theta

Q#6

A share of stock is selling for \$41.30 a share. A six-month call option with a \$40 strike price sells for \$2.10 per share. The risk-free rate is 0.3 percent per month. What is the price per share of a six-month put option with a \$40 strike price?

- A) \$0.09
- B) \$0.14

- C) \$0.20
- D) \$0.26

## Q#7

You recently purchased one share of Wexler stock at a price of \$36.15 per share. You also purchased a one-year put option on Wexler stock with a \$32.50 strike price. The cost of the put was \$0.10 per share. What is the maximum amount per share you can lose during the one-year option period?

- A) -\$3.75
- B) -\$3.55
- C) -\$0.10
- D) \$0

## Q#8

Today, you purchased a one-year risk-free asset which pays 4% interest at a cost of \$48.08. You also purchased a one-year call option on Jasper stock with a strike price of \$35 and a cost of \$1.45. How much total profit will you earn on these investments if the stock is worth \$37.10 one year from now?

- A) \$0.65
- B) \$2.57
- C) \$3.19
- D) \$4.02

## Q#9

DL stock has a current market price of \$38.60 per share. The one-year call on this stock with a strike price of \$35 is priced at \$4.80 per share. The one-year put on this



stock with a strike price of \$35 is priced at \$0.05 per share. What is the risk-free rate of return?

- A) 3.40 percent
- B) 3.59 percent
- C) 4.01 percent
- D) 4.23 percent

## Q#10

A stock is selling for \$41.70 a share and has a standard deviation of 52 percent. A 3-month European option on the stock has an exercise price of \$40. The risk-free rate is 3.5 percent, compounded continuously.  $N(d1)$  is 0.62693 and  $N(d2)$  is 0.52541. What is the value of the 3-month, \$40 call option?

- A) \$3.38
- B) \$3.59
- C) \$4.68
- D) \$5.31

## Q#1

Which one of the following terms best fits a merger between two firms whereby a totally new firm is created and both of the existing firms cease to exist as independent firms?

- A) joint venture
- B) consolidation
- C) buyout

- D) strategic alliance

## Q#2

If a food wholesaler purchases a grocery store, it has made a \_\_\_\_\_ acquisition.

- A) proxy
- B) horizontal
- C) **vertical**
- D) lateral

## Q#3

Jack is a major shareholder of Lexington Homes stock. Currently, he is quite upset with the firm's management and thus has decided to try and gain control of the firm by soliciting enough shareholder votes to replace the current managers. Which one of the following terms is used to describe this attempt?

- A) going-private
- B) **proxy contest**
- C) stock swap
- D) leveraged buyout

## Q#4

The difference between the purchase price of a firm and the estimated fair market value of the firm's net assets is called:

- A) **goodwill.**
- B) synergy.

- C) excess capital.
- D) merger revenue.

## Q#5

Firm A is worth \$10,000. Firm B is worth \$10,000. The combined Firm AB is worth \$22,000. The additional \$2,000 of value that is created by combining Firms A and B is called:

- A) goodwill.
- B) excess capital.
- C) synergy.**
- D) the pooling effect.

## Q#6

Which one of the following statements is true?

- A) The value of a merger to the acquiring firm increases as the merger premium increases.
- B) Stock acquisitions tend to be less complicated than cash acquisitions.
- C) If the managers of the acquiring firm do not wish to lose any of their managerial control, they should acquire other firms with cash, rather than stock**
- D) An acquisition completed by exchanging shares of stock is generally a taxable transaction.

## Q#7

Johnston Mfg. is purchasing Delta Tools for \$21.5 million in cash. The fixed assets of Delta Tools were recently appraised at \$16.9 million. In addition, Delta Tools has \$2.6 million in working capital and no debt. Johnston Mfg. will use the purchase accounting method to record this acquisition. What is the amount of the goodwill that will be shown on the books of Johnston Mfg. after the acquisition?

- A) \$0
- B) \$2.0 million**
- C) \$3.4 million
- D) \$4.6 million

## Q#8

Miller Sporting Goods is acquiring Town Line Sports for \$327,000 in cash. Currently, Miller Sporting Goods has 12,500 shares of stock outstanding at a market price of \$54 a share. Town Line Sports has 12,000 shares outstanding at a price of \$26 a share. Neither firm has any debt. The incremental value of the acquisition is estimated to be \$16,500. What is the merger premium per share?

- A) \$1.25**
- B) \$3.75
- C) \$14.00
- D) \$28.00

## Q#9

JT's is being acquired by Bruno's for \$15,000 of Bruno's stock. JT's has 600 shares of stock outstanding at a price of \$12 per share. Bruno's has 5,000 shares outstanding at a price of \$38 a share. The incremental value of the acquisition is \$1,500. What is the value of JT's to Bruno's?

- A) \$16,500

- B) \$5,700
- C) \$7,200
- D) \$8,700**

## Q#10

Denver Mines is merging with Mountain Glory. Denver Mines will pay the shareholders of Mountain Glory the current value of their stock in shares of Denver Mines. Currently, Mountain Glory has 1,500 shares outstanding at a price of \$23 a share. Denver Mines has 6,500 shares outstanding at a price of \$41 a share. How many shares of stock will be outstanding in the merged firm?

- A) 6,829 shares
- B) 7,341 shares**
- C) 7,558 shares
- D) 8,000 shares

## Q#1

A lease where the payments are insufficient to cover the total cost of the leased asset and the lessor is responsible for the taxes and insurance is called a(n) \_\_\_\_\_ lease.

- A) operating**
- B) capital
- C) financial
- D) purchase

## Q#2

A lease in which the lessor borrows money on a nonrecourse basis to finance the cost of the leased asset is called a(n) \_\_\_\_\_ lease.

- A) capital
- B) financial
- C) leveraged**
- D) sale and leaseback

## Q#3

Which of the following discount rates should be used when computing the net advantage to leasing?

- A) lessor's pre-tax
- B) lessor's aftertax
- C) lessee's pre-tax
- D) lessee's aftertax**

## Q#4

Which one of the following is a correct description of a standard used to determine if a lease is valid for IRS purposes?

- A) The term of the lease must be less than 75 percent of the economic life of the asset.
- B) The payments at the beginning of the lease period must be significantly higher than those at the end of the lease period.
- C) The asset must be sold to the lessee for less than fair market value at the end of the lease term.

D) The lessor must have a reasonable expectation of making a pre-tax profit.

Q#5

When computing the net advantage to leasing, the cash flow at time zero is equal to:

- A) the cost of the asset.
- B)  $(\text{the cost of the asset}) \times (1 - \text{tax rate})$ .
- C) the aftertax lease payment plus the lost depreciation tax shield.
- D) the amount of the annual lease payment.

Q#6

High Tower Bakery is debating whether to lease or to buy an asset. The asset costs \$36,000, has a 3-year life, and will be worthless after the 3 years. Leasing the asset will cost \$13,500 a year. The firm uses straight-line depreciation and has a tax rate of 35 percent. What is the incremental cash flow for year 2 if the firm decides to lease rather than buy?

- A) -\$16,575
- B) -\$17,580
- C) -\$11,840
- D) -\$12,975

Q#7

An asset costs \$52,000, has a 4-year life and will be worthless after the 4 years. The firm uses straight-line depreciation, has a pre-tax cost of capital of 12 percent, and

a tax rate of 35 percent. The asset can be leased for \$14,750 a year. What is the net advantage to leasing?

- A) \$2,515
- B) \$4,966**
- C) \$7,208
- D) \$9,059

## Q#8

Moon River Tours is considering either purchasing or leasing some new equipment. The equipment costs \$69,000 and has a 5-year life. At the end of the 5 years the equipment will have an estimated value of \$4,000. The cost of leasing is \$15,000 a year. The firm uses straight-line depreciation, has a pre-tax cost of capital of 14 percent, and has a 34 percent tax rate. What is the incremental cash flow in year 5 if the firm opts to lease rather than buy the equipment?

- A) -\$13,930
- B) -\$17,232**
- C) -\$19,408
- D) -\$22,560

## Q#9

Chester's Chicken House has a cost of capital of 13 percent, a tax rate of 32 percent, and uses straight-line depreciation. The company is considering buying some equipment for \$27,000. The equipment has a 3-year life and no salvage value. The equipment can be leased for \$9,700 a year. Chester's Chicken House has accumulated net operating losses so does not expect to owe any taxes for the next 4 years. What is the net advantage to leasing?

- A) \$3,627



- B) \$2,829
- C) \$3,411
- D) \$4,097**

## Q#10

Al's Bait Shop is considering either purchasing or leasing some new equipment. The equipment costs \$17,000 and has a 4-year life. At the end of the 4 years the equipment should be worth \$1,500. The cost of leasing is \$4,900 a year. Al's Bait Shop uses straight-line depreciation, has a cost of capital of 12.5 percent, and has a 30 percent tax rate. What is the amount of the aftertax salvage value?

- A) \$450
- B) \$1,050**
- C) \$1,500
- D) \$1,950

## Q#1

Business finance includes determining which long-term assets a firm should purchase.

- A) True**
- B) False

## Q#2

The board of directors has the power to act on behalf of the shareholders to hire and fire the operating managers of the firm. In a legal sense, the directors are "principals" and the shareholders are "agents."

A) True

**B) False**

Q#3

In capital budgeting, the financial manager tries to identify investment opportunities that will increase the value of the firm.

**A) True**

B) False

Q#4

Three advantages of the corporate form of organization are the ease of transfer of ownership, limited liability for the shareholders and an unlimited life for the business entity.

**A) True**

B) False

Q#5

The intent of the Sarbanes-Oxley Act of 2002 is to protect the public from accounting fraud and financial malpractice.

**A) True**

B) False

Q#6

Financial managers are responsible for determining:

I. how suppliers will be paid.

II. the appropriate level of debt for a firm.

III. which projects a firm should undertake.

IV. how to invest the firm's cash.

- A) I and II only
- B) II and III only
- C) I, II and III only
- D) II, III and IV only
- E) I, II, III and IV**

## Q#7

Ann is interested in purchasing Ted's factory. Since Ann is a poor negotiator, she hires Mary to negotiate a purchase price. Identify the parties to this transaction.

- A) Mary is the principal and Ann is the agent.
- B) Ted is the principal and Ann is the agent.
- C) Ted is the agent and Ann is the principal.
- D) Ann is the principal and Mary is the agent.**
- E) Mary is the principal and Ted is the agent.

## Q#8

Which of the following apply to dealer markets?

- I. over-the-counter trading
- II. individuals buying and selling for themselves, at their own risk
- III. a market with a physical location
- IV. the matching of buyers with sellers

- A) I and II only**
- B) II and III only
- C) III and IV only
- D) I, II and IV only
- E) I and IV only

## Q#9

At least one of the owners has unlimited liability under which of the following forms of business organization?

I. sole proprietorship

II. general partnership

III. limited partnership

IV. limited liability company

- A) I and II only
- B) II and III only
- C) I, II and IV only
- D) I, II and III only**
- E) I, II, III and IV

**Q#10**

Tasks related to tax management, cost accounting, financial accounting, and data processing are the responsibility of which corporate officer?

- A) treasurer
- B) chief executive officer
- C) controller**
- D) chairman of the board
- E) chief operations officer

**Q#11**

All stocks that trade on the New York Stock Exchange are:

- A) over-the-counter securities.
- B) primary market securities.
- C) AMEX securities.
- D) listed securities.**

- E) privately placed securities.

## Q#12

Which of the following statements regarding agency problems and costs are correct?

- I. An agency problem exists when there is a conflict of interest between the stockholders and the management of a firm.
- II. An agency problem exists when there is a conflict of interest between a principal and an agent.
- III. An agency cost occurs when firm management avoids risky projects that would favorably affect the stock price because the managers are worried about keeping their jobs.
- IV. An agency cost occurs when management chooses an action that benefits the shareholders but reduces management compensation.

- A) I and II only
- B) II and III only
- C) I, III and IV only
- D) I, II and III only**
- E) II, III and IV only

## Q#13

Which of the following are stakeholders in a firm?

- I. employees
- II. customers
- III. stockholders
- IV. government

- A) I and II only
- B) III only

- C) I and III only
- D) II and IV only
- E) I, II and IV only**

## Q#14

Which one of the following statements concerning the financial markets is correct?

- A) There are about three times as many companies listed on NASDAQ as on the NYSE.**
- B) The NYSE lists about 85 percent of all firms that trade publicly.
- C) In general, stocks listed on NASDAQ trade more actively than those listed on the NYSE.
- D) All large firms, such as General Electric and Microsoft, trade on the NYSE.
- E) The trading floor for NASDAQ is located in Chicago.

## Q#15

Under which of the following forms of business organization are the losses to an owner limited to the amount which he or she has invested in the organization?

- I. common stockholder
- II. limited partner
- III. general partner
- IV. sole proprietor

- A) I only
- B) I and II only**
- C) I, II and IV only
- D) II, III and IV only
- E) II and III only

## Financial Statements, Taxes, and Cash Flow

### Q#1

According to Generally Accepted Accounting Principles (GAAP), assets are carried on the financial statements at the higher of current market value or historical cost.

A) True

**B) False**

### Q#2

Suppose KLM, Inc., just received a patent on a new anti-cholesterol drug. This patent is an intangible fixed asset.

**A) True**

B) False

### Q#3

A noncash item is an expense charged against revenues that does not directly affect the cash flow.

**A) True**

B) False

### Q#4

Operating cash flow is the cash generated from a firm's normal business activities related to production and sales.

**A) True**

B) False

### Q#5

A highly liquid asset is an asset that can be converted into cash quickly by greatly reducing the selling price.

A) True

**B) False**

Q#6

Net capital spending is equal to:

**A) ending net fixed assets minus beginning net fixed assets plus depreciation.**

B) beginning net fixed assets plus ending net fixed assets minus depreciation.

C) ending net fixed assets minus beginning net fixed assets minus depreciation plus taxes.

D) ending net fixed assets minus beginning net fixed assets plus depreciation minus taxes.

E) beginning net fixed assets minus ending net fixed assets plus depreciation.

Q#7

Which one of the following statements is true?

A) Accounting income is generally equal to operating cash flow.

B) Assets are usually listed on the balance sheet at current market value.

**C) Accounting statements are usually prepared to match the timing of income and expenses.**

D) The balance sheet equity account represents the market value of the firm to shareholders.

E) The balance sheet tells investors exactly what the firm is worth.

Q#8

Which one of the following is generally considered the most liquid?

**A) accounts receivable**

B) inventory



- C) net fixed assets
- D) intangible assets
- E) tangible assets

## Q#9

Cash flow to creditors is equal to:

- A) the interest paid.
- B) operating cash flow minus net new borrowing.
- C) interest paid plus changes in short-term debt.
- D) interest paid plus total new debt.
- E) interest paid minus net new borrowing.**

## Q#10

Intangible assets:

- A) are generally considered highly liquid.
- B) are listed on the balance sheet just before accounts receivable.
- C) include such things as patents and trademarks.**
- D) include any fixed asset that exists physically.
- E) are expensed when acquired.

## Q#11

Paid-in surplus is part of:

- A) net working capital.
- B) long-term debt.
- C) net fixed assets.
- D) owners' equity**
- E) short-term debt.

## Q#12

Which one of the following statements is correct?

- A) Stockholders' equity is equal to total assets plus total liabilities.
- B) Net working capital is equal to current liabilities minus current assets.
- C) Cash flow from assets is equal to cash flow to creditors minus cash flow to stockholders.
- D) Additions to net working capital are equal to ending net working capital minus beginning net working capital plus depreciation.
- E) Operating cash flow is equal to EBIT plus depreciation minus taxes.**

## Q#13

Use the following tax table to answer this question.

Taxable Income	Tax Rate
\$0-50,000	15%
\$50,001-75,000	25%
\$75,001-100,000	34%
\$100,001-335,000	39%

Pools, Inc., has taxable income of \$77,000 for the year. Which one of the following statements is correct concerning Pools' tax situation?

- A) Pools' average tax rate is 18.74 percent.**
- B) Pools' average tax rate is 34.00 percent.
- C) Pools' marginal tax rate is 15.00 percent.
- D) Pools' marginal tax rate is 18.74 percent.
- E) Pools' marginal tax rate is 39.00 percent.

## Q#14

Wise, Inc., paid \$31,000 in interest last year while long-term debt decreased from \$310,000 to \$250,000. What was the cash flow to creditors?

- A) -\$31,000
- B) -\$29,000
- C) \$31,000
- D) \$60,000
- E) \$91,000**

## Q#15

LaMont Industries had cash flow from operations of \$19,300 last year. The depreciation expense was \$2,300, interest expense was \$600, and taxes were \$1,400. They have 40,000 shares of stock outstanding. What is the earnings per share for last year?

- A) \$0.31
- B) \$0.37
- C) \$0.41
- D) \$0.46**
- E) \$0.48

## Working with Financial Statements

### Q#1

If a firm uses cash to purchase inventory, its quick ratio will increase.

- A) True
- B) False**

### Q#2

Asset utilization ratios are intended to describe how efficiently a firm uses its assets to generate sales.

A) True

B) False

Q#3

The Du Pont identity breaks ROE into three components, which are the profit margin, the current ratio, and the equity multiplier.

A) True

B) False

Q#4

When analyzing a financial statement, it is difficult to determine which ratios are most important and what the appropriate range for each ratio should be.

A) True

B) False

Q#5

Market value ratios are measures of financial performance that can be computed for both private and public companies.

A) True

B) False

Q#6

A comparison of the financial statements of two firms in the same general industry may be difficult if:

I. the firm's financial statements are prepared using different fiscal year-ends.

II. one or both firms have international operations.

III. the size of the two firms' operations are different.

A) I only

B) II and III only

C) I and III only

D) I and II only

**E) I, II, and III**

Q#7

Which of the following are incorporated into the calculation of the Du Pont identity?

I. return on assets

II. equity multiplier

III. total asset turnover

IV. profit margin

A) III and IV only

B) I, II, and III only

C) I, III, and IV only

D) II, III, and IV only

**E) I, II, III, and IV**

Q#8

A very short-term creditor, such as a supplier who grants credit for only 30 days, is likely to be most interested in a firm's:

A) current ratio.

B) quick ratio.

C) cash coverage ratio.

**D) cash ratio.**

E) times interest earned ratio.

Q#9

A firm is having difficulty controlling its operating expenses. Which one of the following ratio categories will most directly reflect this problem?

A) liquidity

- B) profitability
- C) market value
- D) turnover
- E) long-term solvency

## Q#10

Golf, Inc., and Swing, Inc., are close competitors. Last year, both had the same amount of cost of goods sold, but Golf turned its inventory 5 times during the year while Swing turned its inventory every 65 days. Which one of the following statements is true if the objective of both firms is to keep average inventory as low as possible?

- A) Golf did a better job since its inventory turnover is lower.
- B) Swing did a better job since its days' sales in inventory is lower.
- C) Golf did a better job since its days' sales in inventory is lower.
- D) Swing did a better job since its inventory turnover is lower.
- E) Golf did a better job since its level of inventory is lower.

## Q#11

CatchaTan Co. had net sales of \$750,000 over the past year. During that time, average receivables were \$150,000. Assuming a 365-day year, what was the average collection period?

- A) 4 days
- B) 5 days
- C) 36 days
- D) 48 days
- E) 73 days

## Q#12

Which of the following is (are) a measure of profitability?

I. return on assets

II. return on equity

III. market-to-book ratio

IV. profit margin

- A) I only
- B) III only
- C) I and II only
- D) III and IV only
- E) I, II, and IV only**

## Q#13

Delta, Inc., has a times interest earned ratio of 3.0. Based on this ratio, a creditor knows that Delta's EBIT must decline by more than \_\_\_\_\_ percent before Delta will be unable to cover its interest expense.

- A) 33
- B) 40
- C) 67**
- D) 75
- E) 80

## Q#14

A firm has sales of \$750, total assets of \$400, and a debt-equity ratio of 1.50. If the return on equity is 10 percent, what is the firm's net income?

- A) \$16**
- B) \$20
- C) \$32
- D) \$40
- E) \$75

## Q#15

The sustainable growth rate illustrates the relationship among which of the following areas?

I. operating efficiency

II. asset utilization

III. dividend policy

IV. financial policy

- A) I, II, and IV only
- B) I, II, and III only
- C) II, III, and IV only
- D) I, III, and IV only
- E) I, II, III, and IV**

## Introduction to Valuation: The Time Value of Money

### Q#1

The future value is the amount an investment is worth after one or more periods.

- A) True**
- B) False

### Q#2

Compounding is the process of accumulating interest in an investment over time to earn more interest.

- A) True**
- B) False

### Q#3

If a lump sum of \$5,000 is invested for four years at 10 percent compounded annually, it will earn total simple interest of \$2,320.50 over that period.



A) True

**B) False**

Q#4

All else equal, the higher the interest rate, the lower the present value of an amount to be received at some point in the future.

**A) True**

B) False

Q#5

Most investments, whether they involve real assets or financial assets, can be analyzed using the discounted cash flow (DCF) approach.

**A) True**

B) False

Q#6

The present value discount factor:

A) is greater than 1.0.

B) is equal to zero when the discount rate is zero.

C) increases as the time period increases.

**D) decreases as the discount rate increases.**

E) increases as the amount invested increases.

Q#7

You will receive a \$50,000 inheritance in 13 years. You could invest that money today at 5.75 percent compounded annually. What is the present value of your inheritance?

A) \$23,798.46

**B) \$24,172.70**

C) \$24,928.03

D) \$25,562.63

E) \$50,000.00

**Q#8**

What is the total future value six years from now of \$125 received in one year, \$250 received in two years, and \$500 received in six years if the discount rate is 9.00 percent?

A) \$1,045.22

B) \$1,047.93

C) \$1,145.57

D) \$1,237.21

E) \$1,269.15

**Q#9**

All else equal, the:

I. present value increases as the discount rate increases.

II. present value increases the further away in time the future value is.

III. present value is always less than the future value when both the interest rate and the number of years are positive.

A) I only

B) II only

C) III only

D) I and II only

E) II and III only

**Q#10**

Assuming a 3 percent annual increase in the price of automobiles, how much will a new BMW cost you 5 years from now if today's price is \$42,000?

A) \$36,230

B) \$40,779

- C) \$46,575
- D) \$48,300
- E) \$48,690**

## Q#11

Five years ago, \$1,200 was deposited into a savings account paying 4.5 percent interest. Today, the balance in the account is \$1,495. If interest paid on the account was compounded annually, how much interest on interest was earned?

- A) \$25.00**
- B) \$93.10
- C) \$102.39
- D) \$130.28
- E) \$295.00

## Q#12

Given the following end-of-year cash flows, what is the future value at the end of year 3 of the second cash flow if the interest rate is 6 percent?

Year	Cash Flow
1	\$450
2	\$625
3	\$550

- A) \$589.62
- B) \$618.35
- C) \$662.50**
- D) \$698.00
- E) \$744.39

## Q#13

A savings account, which started with a balance of \$500, has the following end of year balances: Year 1 = \$550; Year 2 = \$580; Year 3 = \$660; Year 4 = \$772; Year 5 = \$950. No withdrawals were made over the life of the account, but there was one additional deposit of \$50 made at the beginning of year 5. If the account earned a total of \$300 in simple interest over its life, how much was earned in interest on interest?

- A) \$25
- B) \$50
- C) \$75
- D) \$100**
- E) \$125

## Q#14

You have \$90,000 saved today and want to purchase a new yacht when your money grows to \$250,000. If you can earn 8 percent on your investments, how long do you have to wait to buy your yacht?

- A) 11.29 years
- B) 12.18 years
- C) 13.27 years**
- D) 14.11 years
- E) 16.67 years

## Q#15

You just paid \$14,960 for a rare model car. You hope to resell the car in three years and earn 15 percent annually on your investment. What selling price will you have to place on the model car? (Round to the nearest whole dollar)

- A) \$17,204
- B) \$19,785
- C) \$20,988
- D) \$21,038
- E) \$22,752**

## Discounted Cash Flow Valuation

### Q#1

An example of an annuity is a stream of payments of \$4,000 each at the end of every year for 20 years.

A) True

B) False

### Q#2

The stated interest rate is the same thing as the effective annual rate.

A) True

B) False

### Q#3

If interest is compounded annually, the effective annual rate and the annual percentage rate will be the same.

A) True

B) False

### Q#4

As a general rule, the effective annual rate is more appropriate for financial decision making than is the annual percentage rate.

A) True

B) False

### Q#5

In almost all present and future value computations, it is implicitly assumed that the cash flows occur at the beginning of each period.

A) True

**B) False**

Q#6

In order to compare different investment opportunities (each with the same risk) with interest rates reported in different manners you should:

- A) convert each interest rate to an effective annual rate.**
- B) convert each interest rate to a monthly nominal rate.
- C) convert each interest rate to an annual nominal rate.
- D) compare the published annual rates.
- E) convert each interest rate to an APR.

Q#7

You have \$1,500 to invest. You have 2 choices: savings account A, which earns 8.75 percent compounded annually or savings account B, which earns 8.50 percent compounded monthly. Which account should you choose and why?

- A) B; because it has a higher effective annual rate**
- B) A; because it has the higher stated rate
- C) A; because it has a higher effective annual rate
- D) B; because the quoted rate is higher
- E) A; because it has the higher quoted rate

Q#8

What is the effective annual rate of 7 percent compounded quarterly?

- A) 7.00 percent
- B) 7.12 percent
- C) 7.19 percent**
- D) 7.23 percent
- E) 7.25 percent

Q#9

You are planning to save your annual bonuses from work and are comparing savings accounts: Account A compounds semiannually, while Account B compounds monthly. If both accounts have the same effective annual rate of interest and you place only the bonuses in the account, you should:

- A) choose account A because it has a higher APR.
- B) choose account B because it has a higher APR.
- C) choose account B because it is compounded more often.
- D) choose account A because you will pay less in taxes.
- E) choose either since you would be indifferent between the**

**two.**

#### Q#10

You are going to withdraw \$600 at the end of each year for the next four years from an account that pays interest at a rate of 6 percent compounded annually. The account balance will reduce to zero when the last withdrawal is made. How much interest will you earn on the account over the four-year life?

- A) \$180.00
- B) \$240.00
- C) \$320.94**
- D) \$420.19
- E) \$433.33

#### Q#11

You borrowed \$2,500 at 9.2 percent compounded annually. Your payments are \$500 at the end of each year. How many years will you make payments on the loan?

- A) 5 years
- B) 6 years
- C) 7 years**
- D) 8 years
- E) 9 years

## Q#12

You own a bond issued by the CP railroad that promises to pay the holder \$100 annually forever. You plan to sell the bond three years from now. If similar investments yield 6 percent at that time, how much will the bond be worth?

- A) \$918.79
- B) \$1,333.34
- C) \$1,666.67**
- D) \$1,789.42
- E) \$1,958.20

## Q#13

The preferred stock of Jay's Comics currently sells for \$23.25 per share. The annual dividend of \$1.50 is fixed. Assuming a constant dividend forever, what is the rate of return on this stock?

- A) 3.49 percent
- B) 6.45 percent**
- C) 8.06 percent
- D) 8.50 percent
- E) 10.00 percent

## Q#14

You deposit \$500 in an account today. You will deposit \$550 at the end of each month for the next 12 months and \$700 at the end of each month for the following 12 months. How much interest will you have earned in 2 years if the account pays 4.5 percent compounded monthly?

- A) \$669.80**
- B) \$727.65
- C) \$749.42
- D) \$862.57
- E) \$879.00



Q#15

You are borrowing \$6,000 today. The loan is an amortized 6-year loan with an APR of 8 percent. The loan requires that \$1,000 of the principal amount be repaid each year. Payments are to be made annually. What is the amount of the interest for the third year of the loan?

- A) \$80
- B) \$160
- C) \$240
- D) \$320**
- E) \$400

### Interest Rates and Bond Valuation

Q#1

For a bond, the required return is equal to the yield-to-maturity which is equal to the market rate.

- A) True**
- B) False

Q#2

A premium bond is a bond that sells for less than its par value.

- A) True
- B) False**

Q#3

In common usage, "short-term" debt refers to debt with a maturity of one year or less.

- A) True**
- B) False

Q#4

Bond yields and prices move inversely with one another.

A) True

B) False

Q#5

The term structure of interest rates is the relationship between real interest rates on default-free, pure discount securities and time to maturity.

A) True

B) False

Q#6

A bond sold five weeks ago for \$1,098. The bond is worth \$1,047 in today's market. Assuming no changes in risk, which one of the following is true?

A) The face value of the bond must be \$1,100.

B) The bond must be within one year of maturity.

C) Interest rates must be lower now than they were five weeks ago.

D) The bond's current yield has increased from five weeks ago.

E) The coupon payment of the bond must have increased.

Q#7

If a 10-year bond's coupon rate is less than the required rate, then:

A) the holder of the bond is guaranteed a profit when the bond is sold, regardless of when it is sold.

B) a portion of the return a buyer of this bond will earn will come from buying the bond at a discount.

C) the bond sells at par because the required rate of return is adjusted to reflect the discrepancy.

D) the bond sells at a premium because it is a long-term bond.

E) the bond will be repaid by the issuer at a discounted price.

Q#8

Which of the following statements about bond ratings is (are) accurate?

- I. Bond ratings are typically paid for by a company's bondholders.
- II. Bond ratings are based solely on information acquired from sources other than the bond issuer.
- III. Bond ratings represent an independent assessment of the credit-worthiness of bonds.

- A) I only
- B) III only**
- C) I and II only
- D) I and III only
- E) II and III only

**Q#9**

Which of the following risks do debt ratings specifically attempt to assess?

- I. interest rate
- II. default
- III. call

- A) I only
- B) II only**
- C) I and II only
- D) II and III only
- E) I, II, and III

**Q#10**

All else equal, the existence of a \_\_\_\_\_ will increase the required return on a bond.

- A) call provision**

- B) conversion feature
- C) put provision
- D) trust deed
- E) protective covenant

## Q#11

Which of the following statements is (are) true?

- I. All else equal, the value of a perpetual bond will remain unchanged from one year to the next, unless market interest rates change.
- II. All else equal, bond prices and coupon rates are inversely related.
- III. All else equal, given two bonds identical but for coupon, the market price of the lower coupon bond will change more (in percentage terms) than that of the higher coupon bond for a given change in market interest rates.

- A) I only
- B) I and II only
- C) I and III only**
- D) II and III only
- E) I, II, and III

## Q#12

The \_\_\_\_\_ is known as the term structure of interest rates.

- A) inflation premium
- B) interest rate risk premium
- C) Fisher effect
- D) relationship between short and long-term interest rates**
- E) municipal bond yield curve

## Q#13

Which one of the following is true?

- A) If the rate of inflation is expected to decline by a small amount, there cannot be an upward-sloping term structure of interest rates.
- B) Investors demand an extra yield on a nontaxable bond as compensation for the unfavorable tax treatment.
- C) The compensation investors demand for bearing interest rate risk adds a downward slope to the term structure of interest rates.
- D) The compensation investors demand for buying bonds that don't trade very often is called a default premium.
- E) A bond's yield is typically calculated assuming that all of the promised coupon and principal payments will be made.**

## Q#14

You earn a 5 percent real return. If the inflation rate is 4 percent, what is your nominal return?

- A) 0.96 percent
- B) 1.09 percent
- C) 9.05 percent
- D) 9.20 percent**
- E) 10.92 percent

## Q#15

A Treasury bond is quoted at a price of 101:23. What is the price of this bond?

- A) \$987.85
- B) \$1,010.23
- C) \$1,012.30
- D) \$1,017.19**
- E) \$1,178.75

## Equity Markets and Stock Valuation

Q#1

A firm must make its dividend payments to preferred shareholders before it makes any interest payments to its bondholders.

A) True

B) False

Q#2

Most preferred stock has dividends that are cumulative.

A) True

B) False

Q#3

According to the constant growth model, the dividend yield is equal to the required return minus the dividend growth rate.

A) True

B) False

Q#4

The NASDAQ acts as both a primary market and a secondary market for shares of stock.

A) True

B) False

Q#5

A broker and a dealer are the same thing.

A) True

B) False

Q#6

Over the past four years, a company has paid dividends of \$1.00, \$1.10, \$1.20, and \$1.30 respectively. This pattern is expected to continue into the future. This is an example of a company paying a:

- A) dividend that grows by 10 percent each year.
- B) dividend that grows at a constant rate.
- C) dividend that grows by a decreasing amount.
- D) dividend that grows at a decreasing rate.**
- E) preferred stock dividend.

## Q#7

You are considering investing in a firm and wish to place a value on the common stock. The dividend on the firm's stock has not changed in the last five years. Absent any information suggesting future changes in the dividend rate, the most appropriate stock valuation model would be the \_\_\_\_\_ model.

- A) zero growth**
- B) constant growth
- C) nonconstant growth
- D) growing perpetuity
- E) bond pricing

## Q#8

The dividend yield on a stock is similar to the current yield on a bond in that both:

- A) represent how much each security's price will increase in a year.
- B) incorporate the par value into their computation.
- C) represent the security's annual income divided by its price.**
- D) are quarterly yields that must be annualized.
- E) are an accurate representation of the annual return an investor can expect to earn by owning the security.

## Q#9

Which one of the following is true about the differences between debt and common stock?

- A) Debt is ownership in a firm but equity is not.
- B) Creditors have voting power while stockholders do not.
- C) Periodic payments made to either class of security are tax deductible for the issuer.
- D) Interest payments are promised while dividend payments are not.**
- E) Both stockholders and bondholders have voting privileges.

## Q#10

Which one of the following is a violation of the rights of one or more classes of a firm's stakeholders?

- A) paying common dividends when preferred dividends are in arrears**
- B) paying preferred shareholders before common shareholders in a liquidation
- C) allowing preferred shareholders to place members on the board of directors when their dividends have not been paid for some time
- D) allowing common shareholders to vote by proxy when they are unable to attend a shareholders' meeting in person
- E) paying creditors before preferred shareholders in a liquidation

## Q#11

Which one of the following has lost the most importance in recent years because of the SuperDOT system of trading?

2222



- A) commission broker
- B) specialist
- C) floor broker**
- D) floor trader
- E) market maker

## Q#12

Suppose you own 250 shares of MIKO common stock. Two directors are to be elected. Since the firm uses cumulative voting, you can cast as many as \_\_\_\_\_ votes for a single director.

- A) 125
- B) 250
- C) 500**
- D) 750
- E) 1,000

## Q#13

ABC's common stock dividend yield is 2.1 percent. The company just paid a dividend of \$1, it is expected to pay a dividend of \$1.07 one year from now, and dividends are expected to grow at this same rate indefinitely. What is the required rate of return on ABC's stock?

- A) 9.0 percent
- B) 9.1 percent**
- C) 9.3 percent
- D) 10.6 percent
- E) 11.2 percent

## Q#14

Boomer Products, Inc., manufactures "no-inhale" cigarettes. As their target customers age and pass on, sales of the product are expected to decline. Thus, demographics suggest that earnings and dividends will decline at a rate of 3 percent annually forever. The firm just paid a dividend of \$1.50. Given a required return of 12 percent, the stock should sell for:

- A) **\$9.70.**
- B) \$10.50.
- C) \$15.00.
- D) \$17.17.
- E) \$32.50.

## Q#15

A web site which allows investors to trade directly with each other is referred to as:

- A) the SuperDot system.
- B) **an electronic communications network, or ECN.**
- C) the NASDAQ.
- D) the order flow.
- E) the Philadelphia Exchange

## Net Present Value and Other Investment Criteria

## Q#1

A firm that only accepts projects for which the internal rate of return (IRR) is equal to the firm's required return will, on average, neither create nor destroy wealth for its shareholders.

A) True

B) False

Q#2

The net present value (NPV) decision rule is considered the best in theory.

A) True

B) False

Q#3

An advantage of the payback rule is that it is easy to understand.

A) True

B) False

Q#4

Two projects that are mutually exclusive are said to be independent.

A) True

B) False

Q#5

If a project has conventional cash flows, it may also have more than one IRR.

A) True

B) False

Q#6

Which of the following is (are) correct?

I. Net present value (NPV) is one of the two or three most important concepts in finance.

II. NPV is the difference between the market value of an investment and its cost.

III. The financial manager acts in the shareholders' best interests by identifying and taking positive NPV projects.

IV. NPVs can normally be directly observed in the market.

- A) I and II only
- B) II and III only
- C) I and IV only
- D) I, II, and III only**
- E) I, III, and IV only

Q#7

Which one of the following statements accurately describes an advantage of the average accounting return (AAR) method of analysis?

- A) The AAR method incorporates time value of money computations.
- B) The estimation of the appropriate cutoff rate for AAR is straightforward and easy.
- C) AAR relies on net income and not cash flows.
- D) AAR relies on book values and not market values.
- E) AAR is relatively easy to compute.**

Q#8

A project should be accepted according to the average accounting return (AAR) whenever the AAR:

- A) exceeds the firm's required AAR.**
- B) exceeds the IRR.
- C) is greater than 100 percent.
- D) is positive.
- E) is less than the IRR.

Q#9

Your firm's CFO presents you with two capital budgeting proposals: one that involves buying a new delivery truck and one that involves building additional

warehouse space. You are to determine which, if either, or both, of these projects should be accepted. This is an example of a decision involving:

- A) mutually exclusive projects.
- B) crossover rates.
- C) interdependent projects.
- D) independent projects.**
- E) longitudinal projects.

**Q#10**

The management of a firm wishes to accept projects with a high degree of liquidity; wishes to avoid the higher forecasting error associated with cash flows a long way into the future; and wishes to avoid projects that require a large amount of research and development. The firm would be justified in using the \_\_\_\_\_ to evaluate its projects.

- A) internal rate of return (IRR)
- B) net present value (NPV)
- C) average accounting return (AAR)
- D) payback method**
- E) profitability index (PI)

**Q#11**

A project that requires an initial cash outlay and for which all remaining cash flows are inflows is said to be:

- A) independent.
- B) conventional.**
- C) mutually exclusive.
- D) value-creating.
- E) short term.

**Q#12**

A manager will prefer the internal rate of return (IRR) rule over the net present value (NPV) rule if the manager:

- A) **prefers to talk in terms of rates of return.**
- B) can accurately forecast future cash flows.
- C) dislikes the payback analysis.
- D) also prefers use of payback analysis.
- E) is considering mutually exclusive projects.

**Q#13**

You undertake a project that requires an initial investment of \$9,000. You expect to receive \$3,100 a year for the next 4 years. If the required return is 15 percent, what is the net present value (NPV)?

- A) -\$235.26
- B) **-\$149.57**
- C) -\$7.58
- D) \$4.63
- E) \$9.44

**Q#14**

You are trying to choose between two projects as you do not have sufficient funding to accept both projects. Each project costs \$80,000. Project A pays \$25,000 a year for 4 years and project B pays \$20,000 a year for 5 years. If your required return is 14 percent, which project should you choose and why?

- A) A; because it pays back sooner
- B) A; because it has a higher IRR
- C) B; because it has a higher NPV
- D) **You should reject both projects.**
- E) You are indifferent between the two projects because each project pays back the same amount.

## Q#15

A project requires an initial investment of \$220,000, which will be depreciated on a straight-line basis over 4 years to a zero book value. A 20 percent average accounting return (AAR) and a 15 percent internal rate of return (IRR) have been assigned to the project. The estimated annual net income from the project is \$18,100, \$20,500, \$21,500, and \$22,500, respectively. Which one of the following statements is correct concerning this project?

- A) The AAR exceeds the requirement, so the project should be accepted.
- B) The average book value that should be used in the AAR computation is \$55,000.
- C) The AAR will be the same regardless of the depreciation method selected.
- D) The project should be accepted because the IRR exceeds the requirement.
- E) The project should be rejected based on the available information.**

## Making Capital Investment Decisions

### Q#1

Assume a project requires additions to net working capital in each year of its life, all of which will be recovered at the end of the project. In this case, the present value of the net working capital recovery will equal the total dollar outlays for net working capital.

- A) True
- B) False**

### Q#2

To accurately reflect the costs associated with a project, you should exclude interest expenses in the computation of operating cash flows.

A) True

B) False

Q#3

Sunk costs and opportunity costs are often the same thing.

A) True

B) False

Q#4

If net working capital grows from \$1,000 to \$1,500 as a result of taking on a new project, the \$500 increase should be included in the initial outlay for the new project.

A) True

B) False

Q#5

For a cost cutting project, the net present value will generally be negative, but the project should still be accepted.

A) True

B) False

Q#6

A company that has a policy of making only cash sales is considering allowing customers to buy on credit. Which one of the following will probably occur?

A) The accounts receivable will likely increase.

B) The change will provide a source of funds.

C) Total sales will likely decrease.

D) Net working capital will decrease if funding needs are met with long-term liabilities.

E) Expenses will decrease due to monthly billing and collection efforts.



## Q#7

It is important to identify and use only incremental cash flows in capital investment decisions:

- A) because they are the simplest to identify.
- B) only when the stand-alone principle fails to hold.
- C) because ultimately it is the change in a firm's overall future cash flows that matter.**
- D) in order to accommodate unforeseen changes that might occur.
- E) whenever sunk costs are involved.

## Q#8

You are advising Peter who is attempting to decide whether or not to drop one of the college courses he is currently enrolled in. If he drops the course, he will forfeit half of the money spent on tuition. If he stays in the class, he will have to give up his part-time job. His textbook is being replaced by a new edition, so is worthless at this time. Which of the following conclusions is consistent with capital budgeting principles?

- I. Remaining in the class incurs an opportunity cost.
- II. The entire tuition is irrelevant because it is a sunk cost.
- III. The cost of the book is a sunk cost.

- A) I only
- B) I and II only
- C) I and III only**
- D) II and III only
- E) I, II, and III

## Q#9

Consider a \$10,000 machine that will reduce pretax operating costs by \$3,000 per year over a 5-year period. Assume no changes in net working capital and a zero scrap value after five years. For simplicity, assume straight-line depreciation to

zero, a marginal tax rate of 34 percent, and a required return of 10 percent. The net present value of acquiring this machine is:

- A) \$83.
- B) \$449.
- C) \$689.
- D) \$827.
- E) \$1,235.

## Q#10

Given the following information and assuming straight-line depreciation to zero, what is the payback period for this project? The project requires an initial investment of \$900,000; has a life of 6 years; produces cost savings of \$190,000 per year; has a tax rate of 35 percent; and a discount rate of 9 percent. The fixed assets will be sold for \$50,000 at the end of year 6.

- A) 2.54 years
- B) 3.67 years
- C) 3.93 years
- D) 5.10 years
- E) The project never pays back.

## Q#11

Your firm needs a computerized line-boring machine that costs \$90,000 and requires \$16,000 in maintenance costs for each year of its 3-year life. After 3 years, this machine will be replaced. The machine falls into the MACRS 3-year class life category. The MACRS percentages for each year are 33.33 percent, 44.44 percent, 14.82 percent, and 7.41 percent, respectively. Assume a tax rate of 35 percent and a discount rate of 10 percent. Assume the machine can be sold for \$12,000 at the end of year 3. What is the aftertax salvage value of the machine?

- A) \$5,633
- B) \$7,800
- C) \$7,920
- D) \$10,134

E) \$10,678

**Q#12**

Your company just bought a new distillation unit for \$175,000 to be used for research and development. Such equipment has a 3-year MACRS classification. The MACRS percentages are 33.33 percent, 44.44 percent, 14.82 percent, and 7.41 percent, respectively. What is the book value of the distillation unit at the end of year 2?

A) \$12,968.00

**B) \$38,902.50**

C) \$49,833.50

D) \$77,770.00

E) \$116,673.50

**Q#13**

A condominium developer buys three times as much land as is needed to build a planned 50-unit development so that, if things go well, two additional 50-unit developments can be built without having to acquire additional land. The developer is prepared to exercise the option to:

A) quit.

**B) expand.**

C) abandon.

D) wait.

E) rebuild.

**Q#14**

The Sedgwick Company estimates sales of a new product at 5,000 units and \$3.00 per unit. Management feels the sales quantity is accurate within a 10 percent plus-or-minus range while the sales price is accurate within a 5 percent plus-or-minus range. What dollar amount should the company use for total sales in their worst-case scenario analysis of this product?

A) \$12,150

**B) \$12,825**

- C) \$13,500
- D) \$14,250
- E) \$15,000

Q#15

Options for future, related business products or strategies are known as:

- A) strategic options.**
- B) capital rationing options.
- C) options to expand.
- D) options to wait.
- E) contingent options

## Some Lessons from Capital Market History

Q#1

If insiders were allowed to profit on their inside information without penalty, financial markets would be more efficient.

- A) True
- B) False**

Q#2

Investors shouldn't count capital gains as a part of their total return until a security is sold, since the capital gain is really only a "paper gain" up to that point.

- A) True
- B) False**

## Q#3

Your classmate just made \$10,000 in a single day by trading in the stock market. It is reasonable to conclude, therefore, that the efficient market hypothesis cannot be true.

A) True

B) False

## Q#4

In general, the greater the potential reward, the greater the risk.

A) True

B) False

## Q#5

A normal distribution is a symmetric, bell-shaped frequency distribution that is completely defined by its average and standard deviation.

A) True

B) False

## Q#6

When calculating your return on investment you should ignore:

A) paper gains.

B) losses you avoided by not buying a stock that has since decreased in price.

C) dividends that have been declared on a stock you own if you have not yet received the dividend.

D) paper capital losses.

- E) fees you are charged in the process of purchasing a security.

## Q#7

Which one of the following is true about risk and return?

- A) Riskier assets will, on average, earn lower returns.
- B) The reward for bearing risk is known as the standard deviation.
- C) Based on historical data, there is no reward for bearing risk.
- D) An increase in the risk of an investment will result in a decreased risk premium.
- E) In general, the higher the expected return, the higher the risk.**

## Q#8

After careful analysis of previous stock prices, you discover you can make above normal returns on your investments if you buy oil company stocks just before noon on any given trading day and then sell them immediately before the market closes that day. This is:

- A) not a violation of market efficiency.
- B) a violation of weak form efficiency.**
- C) a violation of semistrong form efficiency.
- D) a violation of strong form efficiency.
- E) a violation of all forms of market efficiency.

## Q#9

The lessons from capital market history tell us that:

- I. there is a reward for bearing risk.
- II. the greater the potential reward from a risky asset, the greater is the risk.

III. the NYSE stock exchange is an inefficient market.

- A) I only
- B) II only
- C) I and II only**
- D) I and III only
- E) I, II, and III

**Q#10**

Over the 1926 to 2004 period, the nominal risk premium on long-term government bonds has averaged \_\_\_\_\_ percent per year.

- A) 0.0
- B) 2.0**
- C) 2.2
- D) 8.8
- E) 13.4

**Q#11**

Which one of the following asset classes has displayed the flattest and widest distribution of returns over the 1926-2004 period? Assume that annual security returns are normally distributed.

- A) large company stocks
- B) long-term corporate bonds
- C) small company stocks**
- D) long-term government bonds
- E) U.S. Treasury bills

**Q#12**

An investment earned the following returns over a four-year period: 28 percent, 21 percent, 1 percent, and -36 percent. What is the variance of the returns on this investment?

- A) 0.0618
- B) 0.0824**
- C) 0.1400
- D) 0.1739
- E) 0.2473

**Q#13**

Given the following historical returns, what is the variance?

Year	Return
1	7 percent
2	3 percent
3	19 percent
4	-11 percent
5	-1 percent

- A) .009664
- B) .012080**
- C) .034018
- D) .039644
- E) .048322

**Q#14**

Suppose you purchased 500 shares of Jet-Electro Corporation stock at a price of \$22.50 per share. One year later, the shares are selling for \$21 each. In addition, a dividend of \$1.50 per share was paid at the end of the period. What is the percentage return on the investment?

- A) -7.1 percent
- B) -6.7 percent



C) 0.0 percent

D) 6.7 percent

E) 7.1 percent

#### Q#15

You own a stock which has produced annual returns of 11 percent, 3 percent, 8 percent, and 14 percent over the past four years, respectively. The arithmetic rate of return is \_\_\_\_\_ percent and the geometric rate of return is \_\_\_\_\_ percent.

A) 8.50; 8.92

B) 8.50; 18.92

C) 9.00; 8.92

D) 9.00; 9.92

E) 9.00; 18.92

#### Risk and Return

#### Q#1

If the total risk of firm X is greater than that of firm Y, then the beta of firm X must be greater than that of firm Y.

A) True

B) False

#### Q#2

No matter how much total risk an asset has, only the unsystematic portion is relevant in determining the expected return on that asset.

A) True

B) False

#### Q#3

If world events cause investors to become more risk-averse, you would expect the market risk premium to increase.

A) True

B) False

Q#4

The projected risk premium is defined as the sum of the expected return on a risky investment and the return on a risk-free investment.

A) True

B) False

Q#5

The security market line is based on the principle that the reward-to-risk ratio must be constant for all assets in the market.

A) True

B) False

Q#6

Which one of the following is an accurate statement?

A) To calculate an expected risk premium you need to compute the expected return on an average risky asset and the return on a risk-free asset.

B) The risk premium is the difference between the return on a risky asset and the return on a market portfolio.

C) The expected return on an asset decreases as the firm-specific risk increases.

D) A comparison of two different risky assets can not be simplified by computing the expected return on each asset.

E) The expected return on a security depends on the expected states of the economy but not on the associated probabilities of those states occurring.

Q#7

Diversification works because:

I. unsystematic risk exists.

II. combining stocks into a portfolio reduces the standard deviation of each stock in the portfolio.

III. firm-specific risk can be dramatically reduced if not eliminated.

- A) I only
- B) III only
- C) I and II only
- D) I and III only**
- E) I, II, and III

## Q#8

You are looking at two different stocks. Stock A has a beta of 1.25 and stock B has a beta of 1.30. Which one of the following statements is true about these investments?

- A) Stock A is a better addition to your portfolio.
- B) Stock B is a better addition to your portfolio.
- C) The expected return on stock A will exceed that of stock B.
- D) Stock B has a higher standard deviation than stock A.
- E) Stock A should have the same reward-to-risk ratio as stock B.**

## B.

## Q#9

Which one of the following portfolios would have the least systematic risk?

- A) a portfolio of the common stocks of 100 different companies
- B) a market portfolio
- C) a portfolio half invested in the market portfolio and half invested in Treasury bills
- D) a portfolio half invested in the market portfolio and half invested in stocks with betas of 1.50
- E) a portfolio made up entirely of Treasury bills**

## Q#10

The expected return on a risky asset depends only on that asset's \_\_\_\_\_ risk.

- A) diversifiable
- B) asset-specific
- C) surprise
- D) unique
- E) systematic**

## Q#11

Suppose you have a portfolio comprised of two securities. You have 60 shares of the stock X valued at \$10 per share and 40 shares of stock Y valued at \$3 per share. What is the weight of stock X in the portfolio?

- A) 23 percent
- B) 40 percent
- C) 60 percent
- D) 77 percent
- E) 83 percent**

## Q#12

Which of the following is (are) true?

- I. Systematic risk is all that matters to a well-diversified investor.
- II. The amount of systematic risk in an asset relative to an average risky asset is measured by beta.
- III. Spreading a portfolio across a number of assets will eliminate all of the risk.
- IV. On average, the standard deviation of a portfolio declines as the number of assets in the portfolio is increased but it can not decline to zero.

- A) II and III only
- B) I and II only

- C) I, II, and III only
- D) I, II, and IV only**
- E) I, III, and IV only

## Q#13

You hold four stocks (A, B, C, and D) in your portfolio. The portfolio beta is 1.20. Stock C constitutes 40 percent of the dollar value of your holdings and has a beta of 1.60. If you sell all of your holdings in stock C, and replace them with an equal investment in stock E (which has a beta of 1.25), your new portfolio beta will be:

- A) 1.00.
- B) 1.06.**
- C) 1.12.
- D) 1.25.
- E) 1.32.

## Q#14

There are two expected states of the economy. The probability of a normal economy is 70 percent and the probability of a recession is 30 percent. If the economy is normal, Security A is expected to earn 20 percent and Security B is expected to earn 6 percent. If the economy goes into a recession, Security A is expected to earn 4 percent and Security B is expected to earn 24 percent. What is the expected return on a portfolio that is invested 60 percent in A and 40 percent in B?

- A) 10.89 percent
- B) 11.07 percent
- C) 13.68 percent**
- D) 14.28 percent
- E) 14.79 percent

## Q#15

There are two expected states of the economy. The probability of a boom is 60 percent and the probability of a bust is 40 percent. If the economy booms, stock A is expected to earn 15 percent and stock B is expected to earn 8 percent. If the

economy goes bust, stock A is expected to earn 5 percent and stock B is expected to earn 18 percent. What is the expected return on a portfolio that is equally divided among stock A, stock B, and a risk-free asset? The expected return on the risk-free asset is 4 percent regardless of the state of the economy.

- A) 8.97 percent
- B) 9.00 percent**
- C) 10.11 percent
- D) 11.82 percent
- E) 13.88 percent

## Cost of Capital

### Q#1

For a profitable firm, an increase in the marginal tax rate increases the cost of debt.

- A) True
- B) False**

### Q#2

For the purpose of estimating a firm's cost of debt for a project, you can observe the yield-to-maturity on recently issued bonds with a similar rating and term-to-maturity.

- A) True**
- B) False

### Q#3

Suppose that new information regarding future inflation in the U.S. causes investors to become less risk averse. The security market line (SML) approach indicates that, all else equal, most firms will see their cost of capital increase.

- A) True

**B) False**

**Q#4**

The cost of capital depends primarily on the source of funds, not the use.

A) True

**B) False**

**Q#5**

A firm that uses its weighted average cost of capital (WACC) to evaluate all projects, regardless of their risk level, will tend to become riskier over time.

**A) True**

B) False

**Q#6**

The appropriate discount rate to use when analyzing an investment project is:

A) the rate of return that will result in the highest net present value (NPV).

B) the internal rate of return (IRR) on that investment.

C) equal to the cost of capital based on the firm's existing assets.

**D) the rate of return relevant to the risk level of the project.**

E) the rate of interest the firm would pay if it sold bonds.

**Q#7**

Which of the following statements are accurate concerning the security market line (SML) approach?

I. The SML applies only to firms with stable dividend growth rates.

II. Like the dividend growth model, the SML generally relies on using the past to predict the future.

III. Unlike the dividend growth model, the SML estimate is adjusted for risk.

IV. The quality of the estimate from the SML approach is sensitive to the quality of the estimates of the variables in the model.

- A) I and III only
- B) II and IV only
- C) II and III only
- D) II, III, and IV only**
- E) I, II, III, and IV

## Q#8

Suppose a firm uses a constant weighted average cost of capital (WACC) in determining the value of capital budgeting projects rather than using the security market line. The firm will tend to:

- A) accept profitable, low-risk projects and reject unprofitable, high-risk projects.
- B) accept profitable, low-risk projects and accept unprofitable, high-risk projects.
- C) reject unprofitable, high-risk projects.
- D) become more risky over time due to the continual acceptance of high-risk projects.**
- E) accept profitable, low-risk projects.

## Q#9

Which of the following can be a problem when estimating the cost of equity?

- I. a beta based on historical information
- II. dividend growth rate
- III. market risk premium
- IV. risk-free rate of interest

- A) I and II only
- B) I and IV only



- C) II and III only
- D) I, II, and III only**
- E) I, II, III, and IV

## Q#10

The bonds of Topstone Industries are currently selling for 103.3 percent of their face value. These bonds mature in 14 years and pay an annual coupon of 7 percent of face value. What is Topstone's pre-tax cost of debt?

- A) 6.63 percent**
- B) 7.35 percent
- C) 7.84 percent
- D) 8.60 percent
- E) 9.45 percent

## Q#11

KCE Corporation is currently operating at its target capital structure with market values of \$140 million of equity and \$155 million of debt. KCE plans to finance a new \$25 million project while maintaining the current debt-equity ratio. How much new debt must be issued to fund the project?

- A) \$13.1 million**
- B) \$18.5 million
- C) \$19.6 million
- D) \$24.8 million
- E) \$32.0 million

## Q#12

A firm has 1 million shares of common stock outstanding with a market price of \$5.00 each. It has 2,500 bonds outstanding, each with a market value of \$1,100. The bonds mature in 13 years, have a coupon rate of 10 percent, and pay coupons annually. The firm's beta is 1.3, the risk-free rate is 4.5 percent, the market risk premium is 7 percent, and the tax rate is 34 percent. What is the weighted average cost of capital (WACC)?

- A) 5.45 percent

- B) 6.53 percent
- C) 9.49 percent
- D) 10.81 percent**
- E) 11.65 percent

**Q#13**

Suppose that two firms, A and B, are considering the same project. The project is in the same risk class as firm A's overall operations. The project has an IRR of 13.0 percent. Firm A has a beta of 1.2, while firm B's beta is 0.9. The risk-free rate is 4.5 percent and the market risk premium is 7.0 percent. Which firm(s) should accept the project?

- A) firm A only
- B) firm B only
- C) both firms A and B**
- D) neither firm A nor B
- E) The answer cannot be determined without more information.

**Q#14**

Given the following information, what is the market value of XYZ Corporation?

Common stock      13.6 million shares outstanding, selling at \$31 per share

Bond issue 1   \$600 million total face value, selling at 98 percent of par

Bond issue 2   \$150 million total face value, selling at \$950 per bond

- A) \$697.52 million
- B) \$874.82 million
- C) \$987.24 million
- D) \$1,049.43 million
- E) \$1,152.10 million**

## Q#15

Hartley Psychiatric, Inc., needs to purchase office equipment for its 2,000 drive-in therapy centers nationwide. The total cost of the equipment is \$2,000,000. It is estimated that the aftertax cash inflows from the project will be \$210,000 annually forever. Hartley has a debt-to-value ratio of 60 percent. The firm's cost of equity is 13 percent and its pre-tax cost of debt is 8 percent. The tax rate is 34 percent. What is Hartley's weighted average cost of capital (WACC)?

- A) 6.09 percent
- B) 8.37 percent**
- C) 8.95 percent
- D) 9.05 percent
- E) 9.91 percent

## Leverage and Capital Structure

## Q#1

A firm becomes bankrupt when the value of its debt equals the value of its assets.

- A) True**
- B) False

## Q#2

When a firm files for bankruptcy, the firm often must hire appraisers to determine the fair value of the firm's assets. This is an example of an indirect cost of bankruptcy.

- A) True
- B) False**

## Q#3

For a levered firm, the cost of equity,  $RE$ , is equal to the required return on the firm's assets,  $RA$ .

A) True

**B) False**

Q#4

Homemade leverage is the use of personal borrowing to change the overall amount of financial leverage to which an individual is exposed.

**A) True**

B) False

Q#5

According to the static theory of capital structure, there is an optimal capital structure because financial distress costs exist.

**A) True**

B) False

Q#6

Which one of the following will increase the debt-equity ratio?

A) A firm issues common stock and uses the proceeds to repurchase an equal amount of preferred stock.

B) A firm issues preferred stock and uses the proceeds to repurchase an equal amount of bonds.

C) A firm with positive additions to retained earnings uses the cash it generates to retire existing debt.

D) A firm uses excess cash to repurchase common stock in an amount equal to additions to retained earnings for the year.

**E) A firm issues bonds and uses the proceeds to purchase short-term assets.**

Q#7

Which of the following statements is (are) correct?

I. The total systematic risk of the firm's equity has two parts: business risk and financial risk.

II. Financial risk comes from the use of debt.

III. Most firms in the U.S. maintain high debt-to-equity ratios.

IV. The costs of bankruptcy decrease the attractiveness of debt financing.

A) II and III only

B) I and IV only

**C) I, II, and IV only**

D) II, III, and IV only

E) I, II, III, and IV

## Q#8

All else equal, which of the following claims to a firm's cash flows will tend to increase with decreases in the debt-equity ratio, assuming there are taxes?

I. government's claim in the form of taxes

II. claims from bankruptcy attorneys

III. claims of stockholders

IV. claims of bondholders

**A) I and III only**

B) I and IV only

C) II and IV only

D) I, II, and III only

E) I, II, and IV only

## Q#9

Consider a graph depicting earnings per share (EPS) and earnings before interest and taxes (EBIT) for a firm both with and without debt. At EBIT levels below the break-even point, the firm's EPS will:

- A) benefit from additional debt.
- B) not be affected by changes in the level of debt.
- C) either benefit or be unaffected by a change in the level of debt.
- D) decrease if debt is increased.**
- E) either decrease or be unaffected by a change in the level of

debt.

## Q#10

The equity risk that arises from the capital structure of a firm is called \_\_\_\_\_ risk.

- A) systematic
- B) business
- C) unsystematic
- D) financial**
- E) diversifiable

## Q#11

\_\_\_\_\_ suggests that value-maximizing financial managers will look to the asset side of the balance sheet to increase firm value, since the mix of debt and equity employed is unlikely to affect firm value.

- A) M&M Proposition I, with taxes
- B) M&M Proposition I, without taxes**
- C) the static theory of capital structure
- D) M&M Proposition II, without taxes
- E) M&M Proposition II, with taxes

## Q#12

A firm has 10,000 bonds outstanding, each with a face value of \$1,000, and a coupon payment of \$55 every six months. If the corporate tax rate is 34 percent, what is the annual interest tax shield?

- A) \$187,000
- B) \$374,000**

- C) \$748,000
- D) \$976,000
- E) \$1,240,000

## Q#13

ABC, Inc., has a debt-equity ratio of 1.2. The firm has a cost of equity of 12 percent and a cost of debt of 8 percent. What will the cost of equity be if the target capital structure becomes 67 percent debt and 33 percent equity? The cost of debt will not change. Ignore taxes.

- A) 10.56 percent
- B) 11.12 percent
- C) 13.51 percent**
- D) 13.64 percent
- E) 14.45 percent

## Q#14

Which one of the following sequences is the correct order of events in a Chapter 7 bankruptcy?

- I. a trustee-in-bankruptcy is elected by the creditors
- II. proceeds of the liquidation are distributed to shareholders
- III. a petition is filed in federal court
- IV. proceeds of the liquidation are used to pay both costs and creditors

- A) I, II, III, IV
- B) II, I, IV, III
- C) III, I, II, IV
- D) I, III, IV, II
- E) III, I, IV, II**

## Q#15

Which one of the following is an advantage of a "prepack"?

- A) the ability to avoid filing for bankruptcy
- B) protection of the interests of the current shareholders
- C) a reduction in the time it takes a firm to emerge from bankruptcy**
- D) a guarantee that all creditors will be paid the full value which they are owed
- E) the granting of an extension of time for filing a reorganization plan

### Dividends and Dividend Policy

#### Q#1

A firm that follows a strict residual dividend policy is likely to maintain a stable pattern of dividends over time.

- A) True
- B) False**

#### Q#2

Suppose the personal tax rate on dividend income increases. All else equal, one would expect the cost of equity for high-dividend firms to decrease.

- A) True
- B) False**

#### Q#3

Suppose a firm wishes to transfer cash to its shareholders. The only way to do so is to pay a dividend.

- A) True
- B) False**



Q#4

Dividend stability is usually viewed as a desirable objective for a firm.

A) True

B) False

Q#5

In a world with no taxes or transaction costs, dividend policy matters, but dividends do not.

A) True

B) False

Q#6

A common stock dividend that results in a distribution of capital is called a(n) \_\_\_\_\_ dividend.

A) regular

B) extra

C) special

D) liquidating

E) stock distribution

Q#7

Which one of the following is given as a possible reason for a reverse stock split?

A) to decrease the stock price and, thereby, increase the stock's respectability

B) to fall below the minimum listing requirements of a stock exchange

C) to force out minority shareholders

D) to increase the number of shares outstanding

E) to increase the transaction costs of shareholders

Q#8

When a firm makes a cash payment to shareholders, as the firm has done at the end of each quarter for the past 20 years, it is called a \_\_\_\_\_ dividend.

- A) stock
- B) special
- C) residual
- D) regular**
- E) liquidating

## Q#9

Which one of the following would increase the desirability of a high-dividend payout, from the viewpoint of the shareholder?

- A) The imposition of a tax exemption on the first \$100 of dividend income.**
- B) The imposition of a reduced tax rate on capital gains income.
- C) The imposition of a tax exemption on the first \$100 of capital gains income.
- D) A reduction in brokerage commissions on purchases and sales of shares.
- E) An increase in the number of positive net present value projects available to the firm.

## Q#10

Which of the following will result from a 2-for-1 stock split?

- I. Total shareholders' equity will decrease by 50 percent.
- II. The price per share will fall by 50 percent.
- III. The number of shares outstanding will double.
- IV. The number of shares owned by each individual investor will double.

- A) I and II only
- B) II and III only
- C) I, III, and IV only
- D) II, III, and IV only**
- E) I, II, III, and IV

## Q#11

You own stock in a firm that has 1.25 million shares outstanding. The current stock price is \$13.50 per share. If the company issues a 10 percent stock dividend, what would you expect the stock price to be after the dividend?

- A) \$12.27 per share**
- B) \$12.82 per share
- C) \$13.30 per share
- D) \$13.49 per share
- E) \$13.71 per share

## Q#12

Suppose you purchase 100 shares of stock for \$3.00 per share cum dividend just before the market closes on Friday. The-ex dividend date is the following Monday and the dividend is \$0.25 per share. All else equal and ignoring taxes, your total wealth just after the market opens on Monday morning will be:

- A) \$250.
- B) \$275.
- C) \$300.**
- D) \$325.
- E) \$350.

## Q#13

Rocky Ground Camping Supply has 200,000 shares of stock outstanding, each with a par value of \$5 and a market value of \$15. In addition, there is additional paid in capital of \$950,000 and retained earnings of \$1,450,000. Suppose the firm declares a

20 percent (small) stock dividend. What is the stock's new price per share? Assume there are no taxes or transaction costs.

- A) \$7.50
- B) \$9.25
- C) \$10.00
- D) \$12.50**
- E) \$13.25

**Q#14**

Sesame Sweet, Inc., has 220,000 shares outstanding with a par value of \$1 per share and a market price of \$12.00 per share. Capital in excess of par amounts to \$540,000, while retained earnings is \$275,000. There is no treasury stock and there are no transaction costs. Suppose Sesame Sweet declares a 10 percent (small) stock dividend. What is the stock's new price per share after the dividend?

- A) \$10.48 per share
- B) \$10.91 per share**
- C) \$11.24 per share
- D) \$12.09 per share
- E) \$13.00 per share

**Q#15**

If you consider taxes, then the price of a stock tends to \_\_\_\_\_ when the stock goes ex-dividend.

- A) increase by the aftertax dividend amount
- B) increase by the pre-tax dividend amount
- C) remain constant
- D) decrease by the aftertax dividend amount**
- E) decrease by the pre-tax dividend amount

## Raising Capital

### Q#1

Venture capitalists frequently hold voting convertible preferred stock giving them various priorities in the event the company is sold or liquidated.

**A) True**

B) False

### Q#2

At each stage of financing for a firm, the value of the founder's stake typically grows and the probability of success rises.

**A) True**

B) False

### Q#3

The risk that new securities will be sold at a loss is transferred from the issuing firm to the underwriter in a best efforts underwriting.

A) True

**B) False**

### Q#4

More than half of new corporate debt is raised through private placements.

**A) True**

B) False

### Q#5

A seasoned equity offering (SEO) occurs when a firm first issues securities to the public.

A) True

**B) False**

### Q#6

A(n) \_\_\_\_\_ is an issue of securities to the general public on a first come, first served basis.

- A) initial public offering
- B) rights offering
- C) general cash offering**
- D) seasoned issue
- E) private issue

Q#7

Which one of the following is true about underwriting?

- A) The issuing firm, not the underwriter, bears all the risk from adverse price movements in a firm commitment sale.
- B) The method of marketing securities to the public is usually specified by the issuing firm, not the underwriter.
- C) The company, not the underwriter, will generally set the price for a security issue.
- D) The spread, or income received by the underwriter, is the difference between the price paid by the investor and the price the underwriter pays to the issuing firm.**
- E) It is common for a number of underwriters to form a syndicate so that the risk in marketing a security issue falls on the lead manager.

Q#8

The legal fees a firm pays in the process of issuing securities are classified as a(n):

- A) direct expense.**
- B) spread cost.
- C) abnormal return cost.
- D) indirect cost.

- E) Green Shoe option cost.

## Q#9

The \_\_\_\_\_ are the most apt to sue the underwriters if an initial public offering (IPO) is significantly underpriced.

- A) original owners of the firm issuing the securities
- B) investors who purchase shares directly from the underwriters
- C) investors who purchase shares in the aftermarket on the first day of trading
- D) investors who purchase shares in the aftermarket on the second day of trading
- E) investors who purchase shares during the waiting period

## Q#10

Which one of the following occurs if new shares are sold at an offering price that is too low? Assume a firm commitment offering.

- A) Underwriters suffer a financial loss because they are more likely to be unable to sell all of the shares offered.
- B) Markets in general suffer because this is a sign of market inefficiency.
- C) Investors suffer a financial loss because they purchase shares at a price less than their true value.
- D) The investors who purchased these shares are less likely to purchase shares in later IPOs.
- E) The original shareholders of the issuing firm suffer an opportunity loss.

## Q#11

The average first-day return on initial public offerings was highest in the year:

- A) 1975.
- B) 1984.

- C) 1994.
- D) 1999.**
- E) 2002.

## Q#12

Which of the following is (are) required for a firm to use Rule 415?

- I. The issuer must not have had a violation of the Securities Act of 1934 in the past two years.
- II. The company must be rated as investment grade.
- III. The aggregate market value of the firm's outstanding stock must be more than \$150 million.
- IV. The firm can not have defaulted on its debt in the past three years.

- A) I only
- B) II only
- C) I and III only
- D) II, III, and IV only**
- E) I, II, III, and IV

## Q#13

Which of the following is (are) important in choosing a venture capitalist?

- I. financial strength of the venture capitalist
- II. references regarding how successful the venture capitalist has been in the past
- III. venture capitalist's exit strategy

- A) I only
- B) I and III only
- C) I and II only



D) II and III only

**E) I, II, and III**

Q#14

The venture capital used to build a prototype would most likely be:

**A) first-stage financing.**

B) second-stage financing.

C) exit financing.

D) mezzanine level financing.

E) late-stage financing.

Q#15

Based on the information provided in the textbook, the largest average initial return on IPOs during the recent past have occurred in:

A) Thailand.

B) France.

**C) China.**

D) Canada.

E) Switzerland

### Short-Term Financial Planning

Q#1

Most firms have a negative cash cycle.

A) True

**B) False**

Q#2

Increases in liability accounts are activities that decrease cash.

A) True

**B) False**

Q#3

The longer the cash cycle, the more financing a firm requires.

**A) True**

B) False

Q#4

The optimal investment in current assets occurs when the carrying costs are just equal to the shortage costs.

**A) True**

B) False

Q#5

Short-term financing for a firm can either be secured or unsecured.

**A) True**

B) False

Q#6

Which of the following would fall under the heading of short-term financial planning?

I. increasing inventory to better meet the demands of customers

II. making it easier for customers to purchase on credit

III. paying an accounts payable within 10 days to get a discount

IV. purchasing new equipment for the production assembly line

A) I and III only

B) II and III only

C) II, III, and IV only

D) I, II, and IV only

**E) I, II, and III only**

**Q#7**

Which one of the following would decrease the length of the cash cycle, all else equal?

A) increasing the inventory period

B) decreasing the inventory turnover rate

**C) increasing the accounts receivable turnover rate**

D) increasing the accounts payable turnover rate

E) granting customers another 15 days to pay their accounts

**Q#8**

Which one of the following is true?

**A) A line of credit is an agreement which authorizes a firm to borrow up to a specified amount and which frequently requires a cleanup period.**

B) A noncommitted line of credit is a formal lending agreement between a borrower and a lender.

C) As a business owner and regular short-term borrower, it would generally be less comforting to have a committed line of credit than an uncommitted one.

D) A revolving credit arrangement is evaluated on an annual basis.

E) In a factoring arrangement, the default risk on the accounts remains with the selling firm.

**Q#9**

Which one of the following questions falls under the heading of short-term finance?

A) Should a manufacturing plant be expanded to increase production capacity?

- B) Should a firm issue debt or equity securities?
- C) How much of a firm's current income should be paid out as dividends?
- D) Should a firm offer straight bonds or convertible bonds?
- E) How much money should a firm raise by issuing commercial paper?**

## Q#10

The \_\_\_\_\_ is the period of time between the purchase of inventory and the payment for the purchase.

- A) accounts receivable period
- B) inventory period
- C) accounts payable period**
- D) cash cycle
- E) operating cycle

## Q#11

A firm with a flexible short-term financial policy will have:

- A) a relatively low ratio of current assets to sales.
- B) relatively few marketable securities.
- C) a relatively low ratio of short-term debt to long-term debt.**
- D) a relatively high amount of short-term debt.
- E) a relatively low level of inventory.

## Q#12

Suppose the inventory period is 50 days, the accounts receivable period is 40 days, and the accounts payable period is 35 days. What is the cash cycle?

- A) 25 days
- B) 45 days

C) 55 days

D) 90 days

E) 135 days

**Q#13**

On May 15, your firm receives 20 cases of designer pens. On June 30, your firm pays \$3,250 for the pens. On July 15, the pens are sold on credit for \$10,500. On September 10, your firm collects the receivable in full. How many days are in the operating cycle, assuming there are 30 days in each month?

A) 45 days

B) 60 days

C) 70 days

D) 90 days

E) 115 days

**Q#14**

Juno, Inc., had sales of \$8,000 in November and \$14,000 in December. The firm projects sales of \$10,000 in January, \$12,000 in February, and \$8,000 in March. Purchases are 70 percent of the next month's sales. The firm collects its receivables in 60 days and pays its payables in 30 days. All sales and purchases are on credit. What is Juno's accounts payable balance at the end of January? Assume each month has 30 days.

A) \$5,600

B) \$7,000

C) \$8,400

D) \$9,200

E) \$11,100

**Q#15**

Which of the following statements are accurate concerning a short-term financial plan?

- I. A short-term financial plan helps project the short-term borrowing needs of a firm.
- II. Firms generally maintain a minimal level of cash.
- III. Interest on short-term debt is a source of cash.
- IV. Compiling a short-term financial plan provides time for managers to arrange financing.

- A) I and II only
- B) III and IV only
- C) I, II, and IV only**
- D) II, III, and IV only
- E) I, II, III, and IV

## Working Capital Management

### Q#1

The only benefit of a lockbox system is a reduction in processing time.

- A) True
- B) False**

### Q#2

Float is the difference between book cash and bank cash.

- A) True**
- B) False

### Q#3

The financial manager of a firm is mostly interested in the company's book balance of cash, not its available balance.

- A) True

**B) False**

Q#4

In accounts receivable management, credit analysis is the process of determining the probability that customers will not pay.

**A) True**

B) False

Q#5

Most trade credit is offered on open account although, at times, a firm may require the customer to sign a promissory note.

**A) True**

B) False

Q#6

Which one of the following is true regarding cash management?

**A) The basic objective in cash management is to keep the investment in cash as low as possible while still operating efficiently and effectively.**

B) A cost of holding cash is the liquidity it gives the firm.

C) A cost of holding cash is the interest income earned on the outstanding cash balance.

D) A firm should decrease its cash holdings as long as the net present value (NPV) of doing so is negative.

E) Effective cash management results in minimization of the total interest earnings involved with holding cash.

Q#7

Which one of the following is true regarding a lockbox arrangement?

A) Lockboxes are one of the most widely used devices to speed up the disbursement of cash.

B) A large corporation may maintain more than 20 lockboxes across the country.

C) A lockbox arrangement increases mail delay by reducing mail time.

D) A lockbox arrangement increases processing time.

E) The payments are usually removed from the lockbox by company employees and then taken to the bank.

## Q#8

Money market securities generally have the following characteristics: short \_\_\_\_\_, low \_\_\_\_\_, and high:

A) maturities; default risk; marketability.

B) maturities; marketability; default risk.

C) marketability; maturities; default risk.

D) marketability; default risk; maturities.

E) default risk; marketability; maturities.

## Q#9

Big Toys, Inc., has a 34 day inventory period and a 23 day receivables period. The company purchases the toys which it sells from The Toy Co. under a 45 day payment arrangement. The Toy Co:

A) should expect payment within 34 days.

B) receives payment for each shipment prior to Big Toys reselling the toys in the shipment.

C) can be assured that Big Toys will be able to convert its inventory into cash before having to pay for that inventory.

D) will have no need to offer a discount period.

E) finances a portion of Big Toys' receivables period.

## Q#10



ABC Co. is considering granting credit to a new corporate customer but is concerned about the customer's credit history. Which of the following would provide useful information to ABC as they decide whether or not to grant credit to this customer?

- I. the customer's financial statements
- II. an Experian report
- III. a credit report from the customer's bank
- IV. a Dun and Bradstreet report

- A) III only
- B) I and III only
- C) II and IV only
- D) I, II, and III only
- E) I, II, III, and IV**

## Q#11

Upon graduation as a finance major, you accept a position with a medium-sized manufacturing firm. Early in your tenure with the firm, you realize that there are several inventory items required in the manufacturing process that make up a small percentage of the overall physical inventory, but represent a large percentage of the inventory value. Anxious to impress your boss, you suggest that the firm start using the \_\_\_\_\_ of inventory management.

- A) EOQ model
- B) derived demand model
- C) shortage cost model
- D) inventory depletion model
- E) ABC model**

## Q#12

Consider a roll of sheet steel. This represents \_\_\_\_\_ inventory to a farm machinery manufacturer and \_\_\_\_\_ inventory to a rolled steel mill.

- A) raw material; work-in-progress
- B) finished goods; work-in-progress
- C) work-in-progress; raw material
- D) finished goods; raw material
- E) raw material; finished goods**

## Q#13

Which one of the following is NOT a consideration included in an EOQ model of inventory management?

- A) shortage costs
- B) carrying costs
- C) kanban**
- D) reorder points
- E) safety stocks

## Q#14

Your company purchased \$10,000 worth of inventory on January 2nd on credit. The terms of the sale were 3/15, net 45. What is the effective annual interest rate if you pay the full amount in 45 days?

- A) 3.1 percent
- B) 28.0 percent
- C) 37.6 percent
- D) 44.9 percent**
- E) 74.3 percent

## Q#15

Karloff's Medical Supply maintains an average inventory of 2,000 imitation human hands for sale to medical schools. The carrying cost per hand per year is estimated to be \$1.25. Karloff places an order for 4,000 hands on the first of each quarter and the order cost is \$80. What will Karloff's total carrying costs be if the firm switches to the EOQ method of inventory?

- A) \$894
- B) \$1,215
- C) \$2,500
- D) \$160,000
- E) \$320,000

## International Aspects of Financial Management

### Q#1

The foreign exchange market is an example of an organized exchange with a specific physical location for trading.

- A) True
- B) False

### Q#2

A Eurobond is an international bond issued in multiple countries but denominated in a single currency.

- A) True
- B) False

### Q#3

There is no mechanism that allows a foreign firm's shares to be traded on an exchange in the U.S.

- A) True
- B) False

### Q#4

The U.S. Treasury bill rate is the rate most international banks charge one another for overnight Eurodollar loans.

A) True

**B) False**

Q#5

A spot trade in the foreign currency market is an agreement to trade currencies based on the exchange rate today for settlement within two business days.

**A) True**

B) False

Q#6

A(n) \_\_\_\_\_ is a security issued in the U.S. which represents a claim on shares of a foreign stock.

**A) American Depositary Receipt**

B) Samurai bond

C) Eurobond

D) swap

E) gilt

Q#7

The rate that most international banks charge one another for loans of Eurodollars overnight is called the:

A) Treasury rate.

B) Samurai rate.

C) European Currency Unit.

**D) London Interbank Offer Rate.**

E) Eurobond rate.

Q#8

The \_\_\_\_\_ will tell you the price of agreeing today to take delivery of a Canadian dollar 60 days from now.

- A) cross-rate
- B) spot exchange rate
- C) forward exchange rate**
- D) London Interbank Offer Rate (LIBOR)
- E) swap rate

## Q#9

A Japanese firm builds a manufacturing plant in the U.S. to avoid transportation charges in bringing its goods to the U.S. market. The Japanese firm is apparently willing to bear the \_\_\_\_\_, which would result from changes in the relative economic conditions between the U.S. and Japan.

- A) long-run exchange rate risk**
- B) remitted cash flow risk
- C) short-run exchange rate risk
- D) translation exposure risk
- E) nationalization risk

## Q#10

Assume that you can exchange \$1.00 U.S. for \$1.55 Canadian today. This is a:

- A) backward rate.
- B) forward rate.
- C) spot rate.**
- D) triangle arbitrage.
- E) fixed rate.

## Q#11

If the percentage difference between the forward exchange rate and the spot exchange rate is equal to the interest rate differential between two countries, then \_\_\_\_\_ holds.

- A) inflation rate parity
- B) interest rate parity**

- C) relative purchasing power parity
- D) absolute purchasing power parity
- E) the cross-rate

## Q#12

Suppose that the current exchange rate is ¥104 per \$1. The inflation rate in the U.S. is expected to be 3 percent per year for the next 4 years. During that same time period, the inflation rate in Japan is expected to be 4 percent per year. Based on relative purchasing power parity, the exchange rate in 4 years should be approximately:

- A) ¥108 per \$1.
- B) ¥110 per \$1.
- C) ¥112 per \$1.
- D) ¥114 per \$1.
- E) ¥116 per \$1.

## Q#13

The current spot rate between Switzerland and the U.S. is SF1.27 per \$1.00. Expected inflation in Switzerland is 9 percent per year and expected inflation in the U.S. is 4 percent per year. If relative purchasing power parity holds, what is the expected exchange rate in 3 years?

- A) SF1.285 per \$1.00
- B) SF1.388 per \$1.00
- C) SF1.470 per \$1.00
- D) SF1.572 per \$1.00
- E) SF2.179 per \$1.00

## Q#14

The U.S. risk-free rate is 5 percent. The British risk-free rate is 2 percent. The spot rate is £.5528. What is the approximate 3-year forward rate if interest rate parity holds?

- A) £.5045 per \$1.00

- B) £.5362 per \$1.00
- C) £.5414 per \$1.00
- D) £.5562 per \$1.00
- E) £.5649 per \$1.00

## Q#15

The following quotes are given as the U.S. \$ equivalent: Canada (dollar) 0.7196, Hong Kong (dollar) 0.1291, Sweden (krona) 0.1400. What is the cross-rate of Canadian dollars per Swedish krona?

- A) C\$0.1946**
- B) C\$0.2612
- C) C\$0.2800
- D) C\$0.3985
- E) C\$0.4918

When evaluating a project in which a firm might invest, both the size and the timing of the cash flows are important.

- A) True**
- B) False

Milo, Inc. spends approximately \$3 million annually to hire auditors to review the firm's financial statements. This is an example of an indirect agency cost.

- A) True
- B) False**

3

The board of directors has the power to act on behalf of the shareholders to hire and fire the operating management of a firm. In a legal sense, the directors are "principals" and the shareholders are "agents."

- A) True
- B) False**

4

The vice-president of finance generally reports directly to the chairman of the board.

- A) True
- B) False**

5

A manager in charge of working capital determines:



- A) how to raise the money required to fund a project.
- B) how much inventory a firm should maintain.**
- C) how many additional shares of stock should be sold.
- D) which projects a firm should undertake.
- E) which fixed assets a firm should purchase.

6

Which one of the following is the best description of the goal of a financial manager in a corporation where shares are publicly traded?

- A) maximize sales growth over the short-term
- B) maximize profits over the short-term
- C) avoid financial distress
- D) maintain steady earnings growth
- E) maximize the current value per share of the existing stock**

7

The duties of a financial manager include determining:

- I. which marketing strategy to use to promote a product.
- II. the most appropriate mix of long-term debt and equity.
- III. which projects a firm should undertake.
- IV. how much short-term debt to utilize.

- A) I and II only
- B) I, II, and III only
- C) II and III only
- D) II, III, and IV only**
- E) I, II, III, and IV

8

Ann is interested in purchasing Ted's factory. Since Ann is a poor negotiator, she hires Mary to negotiate a purchase price. Identify the parties to this transaction.

- A) Mary is the principal and Ann is the agent.
- B) Ted is the principal and Ann is the agent.
- C) Ted is the agent and Ann is the principal.
- D) Ann is the principal and Mary is the agent.**
- E) Ann is the principal and Ted is the agent.

9

A financial manager is responsible for deciding whether or not new manufacturing equipment should be purchased to replace existing equipment. The firm has sufficient cash available to make the purchase. The new equipment would reduce labor expenses and would allow the firm to reduce its investment in inventory. Which of the financial management areas would be involved in this decision?

- I. capital budgeting
- II. capital structure

## III. working capital

- A) I only
- B) I and II only
- C) II and III only
- D) I and III only**
- E) I, II, and III

10

Capital budgeting is the process of:

- A) determining how to raise the money required to fund a project.
- B) choosing how much cash to keep on hand.
- C) deciding the amount of earnings that a firm should retain.
- D) planning and managing a firm's long-term investments.**
- E) deciding what marketable securities to purchase.

## Financial Statements, Taxes, and Cash Flow

1

According to Generally Accepted Accounting Principles (GAAP), assets are generally shown on the financial statements at the higher of current market value or historical cost.

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A) True

B) False

2

There is a tradeoff between the advantages of liquidity and forgone potential profits.

A) True

B) False

Feedback: This statement is true.

3

Suppose Nu-Drugs, Inc. just received a patent on a new drug for diabetes. This patent is considered an intangible fixed asset.

A) True

B) False

4

You are to determine the level of net capital spending by a firm. If you have the balance sheet and income statements, how would you go about your task?

A) ending net fixed assets minus beginning net fixed assets plus depreciation

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- B) beginning net fixed assets plus ending net fixed assets minus depreciation
- C) ending net fixed assets minus beginning net fixed assets minus depreciation plus taxes
- D) ending net fixed assets minus beginning net fixed assets plus depreciation minus taxes
- E) beginning net fixed assets minus ending net fixed assets plus depreciation

5

Balance sheet assets:

- I. always have a value equal to total liabilities minus shareholders' equity.
- II. are listed in order of increasing liquidity.
- III. represent items acquired with the use of liabilities and equity.

- A) I only
- B) II and III only
- C) III only**
- D) I and II only
- E) I, II, and III

6

Which one of the following statements is true?

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- A) Accounting income is generally equal to cash flow.
- B) Assets are usually listed on the balance sheet at market value.
- C) Accounting statements are usually prepared to match the timing of income and expenses.**
- D) The balance sheet equity account represents the market value of the firm to the stockholders.
- E) The balance sheet tells investors exactly what the firm is worth.

7

The changes in current assets relative to current liabilities over a period of time are called the:

- A) net capital spending.
- B) change in net working capital.**
- C) operating cash flow.
- D) change in asset cash flow.
- E) cash flow from assets.

8

Which one of the following statements is generally true regarding liquidity?

- A) Liquidity is detrimental to a firm because it allows the firm to pay its bills more easily, thereby avoiding financial distress.
- B) Liquidity is valuable to a firm because liquid assets can be sold quickly without much loss in value.**

- C) Liquidity is valuable to a firm because a firm can borrow money using its liquid assets, such as a warehouse, as collateral.
- D) Assets are generally listed on a firm's balance sheet in the order of increasing liquidity.
- E) Liquid assets generally earn a large return, especially in comparison to illiquid assets.

9

Additions to net working capital over the course of a year can be computed by:

- A) subtracting depreciation from the difference between ending NWC and beginning NWC.
- B) adding depreciation to the difference between ending NWC and beginning NWC.
- C) adding interest paid to the difference between ending NWC and beginning NWC.
- D) subtracting interest paid from the difference between ending NWC and beginning NWC.
- E) subtracting beginning NWC from ending NWC.**

10

Last year, HD Corporation had \$1 million in operating cash flow, \$500,000 in net capital spending, and a decrease in net working capital of \$25,000. What was the firm's cash flow from assets?

- A) \$475,000
- B) \$525,000**
- C) \$1,000,000

- D) \$1,475,000
- E) \$1,525,000

## Working with Financial Statements

1

Another name for return on equity is return on total capitalization.

- A) True
- B) False**

2

Asset utilization ratios are intended to measure how efficiently or intensively a firm uses its assets to generate sales.

- A) True**
- B) False

3

The profit margin appears on a common-size income statement.

- A) True**
- B) False



4

While financial statements have many uses outside of the company, they are not useful internally.

- A) True
- B) False**

5

Which one of the following correctly identifies the activity categories found on a statement of cash flows?

- A) operating, income statement, financing
- B) investment, purchasing, operating
- C) financing, operating, income statement
- D) operating, financing, investment**
- E) noncash, financing, investment

6

\_\_\_\_\_ ratios are designed to determine a firm's long-run ability to meet its obligations.

- A) Liquidity
- B) Asset-utilization
- C) Profitability
- D) Financial leverage**
- E) Market value

7

Which of the following are directly incorporated into the calculation of the Du Pont identity?

- I. debt-equity ratio
- II. equity multiplier
- III. total asset turnover
- IV. profit margin

- A) I and III only
- B) II and III only
- C) I, II, and III only
- D) I, III, and IV only
- E) II, III, and IV only**

8

Which one of the following is frequently used as a measure of the cash flow available to meet the financial obligations of a firm?

- A) earnings before taxes
- B) earnings before taxes and depreciation
- C) earnings before interest, taxes, and depreciation**
- D) net income
- E) taxable income

9

Which of the following formulas use sales as the numerator?

I. accounts receivable turnover

II. inventory turnover

III. fixed asset turnover

IV. accounts payable turnover

- A) I and II only
- B) I and III only**
- C) II, III, and IV only
- D) I, II, and III only
- E) I, III, and IV only

10

CatchaTan Co. had net sales of \$900,000 and average accounts receivables of \$60,000 last year. How long on average does it take its credit customers to pay their bills?

- A) 6.0 days
- B) 15.0 days
- C) 15.3 days
- D) 24.0 days
- E) 24.3 days**

## Long-Term Financial Planning and Growth

1

Conventional wisdom holds that financial plans don't work, but financial planning does.

A) True

B) False

2

All else equal, a firm that utilizes assets efficiently will have a higher sustainable growth rate than a firm that does not.

A) True

B) False

3

To reduce the amount of external financing needed, a firm may need to lower its rate of growth.

A) True

B) False

4

Actions that increase a firm's ability to generate funds internally decrease its ability to grow without obtaining external financing.

- A) True
- B) False**

5

A firm has a capital intensity ratio of 2.0. Total assets are expected to increase by the same percentage as sales. Given this, then:

- I. assets and sales must increase by identical dollar amounts.
- II. there will be no need for external funding.
- III. the firm is probably operating at full capacity.

- A) I only
- B) III only**
- C) I and III only
- D) II and III only
- E) I, II, and III

6

When doing financial planning, the \_\_\_\_\_ of a firm provide a guide for changes in liabilities and equity.

- A) sales growth expectations
- B) financing and dividend policies
- C) sustainable growth rate expectations

- D) pro forma income statements
- E) working capital policies

7

Which of the following factors affect a firm's ability to grow at its maximum sustainable rate of growth?

- I. total asset turnover
- II. financial policy
- III. dividend policy
- IV. profit margin

- A) II and III only
- B) I and II only
- C) I, III, and IV only
- D) I, II, and III only
- E) I, II, III, and IV**

8

Why is it important to determine if a firm is operating at full capacity?

- A) A firm that is operating at less than full capacity will not need any external financing.
- B) If a firm is operating at less than full capacity, fixed assets will typically increase at the same percent as sales.

C) A firm with excess capacity has some room to expand sales without increasing the investment in fixed assets.

D) For a given increase in sales, firms operating at less than full capacity will experience more rapid asset growth than that experienced by firms that are operating at full capacity.

E) Only firms operating at full capacity can grow rapidly.

9

Which one of the following statements regarding financial planning is accurate?

A) Financial planning ensures a firm will not be surprised by unforeseen future events.

B) By using financial planning, a firm can clearly identify its options for the coming 15 years.

C) The use of financial planning allows a firm to eliminate the interactions between its operating policies and its financing policies.

D) Financial planning allows a firm to plan for the future in a systematic fashion.

E) Financial planning takes the burden of managing the firm off of the financial manager and places it all on the operations manager.

10

Suppose a firm is working at full capacity and that assets and costs are tied directly to the level of sales. Also assume the firm pays out all its earnings as dividends. The sales are expected to increase by 10 percent next period. The external funding needed to support this level of growth:

A) is zero since no liabilities are tied directly to the level of sales.

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- B) depends on the profit margin.
- C) depends on the ratio of fixed assets to total sales.
- D) depends on the current debt-equity ratio.
- E) is equal to the growth rate times total assets.**

## Introduction to Valuation: The Time Value of Money

1

Interest on interest is interest earned on the reinvestment of previous interest payments.

**A) True**

B) False

2

Simple interest is interest earned only in the first year of an investment.

A) True

**B) False**

3

If a lump sum of \$10,000 is invested for three years at 10 percent compounded annually, it will earn a total of \$3,310 in interest over that period.



A) True

**B) False**

4

All else equal, the higher the interest rate, the higher the future value of an investment will be.

**A) True**

B) False

5

Suppose you are trying to find the present value of two different cash flows using the same interest rate for each cash flow. The first cash flow is \$1,000 ten years from now. The second is \$800 seven years from now. Which one of the following is true about the discount factors used to value the cash flows?

**A) The factor for the cash flow 10 years away is always less than or equal to the factor for the cash flow that is received seven years from now.**

B) Both factors are greater than 1.

C) Regardless of the interest rate, the discount factors are such that the present value of the \$1,000 will always be higher than the present value of the \$800.

D) Since the payments are different, no statement can be made regarding the factors to be used.

E) The astute investor will factor in the time differential and choose the payment that arrives the soonest.

6

You just won the lottery and want to put some money away for your child's college education. When your child goes to college 18 years from now, the cost will

be \$65,000. You can earn 8 percent compounded annually. How much do you need to invest today?

- A) \$9,828.18
- B) \$11,763.07
- C) \$13,690.82
- D) \$15,258.17
- E) \$16,266.19**

7

You need \$2,000 to buy a new stereo for your car. If you have \$800 to invest at 5 percent compounded annually, how long will you have to wait to buy the stereo?

- A) 6.58 years
- B) 8.42 years
- C) 14.58 years
- D) 15.75 years
- E) 18.78 years**

8

You are going to receive \$100 four years from today. If the discount rate is 5 percent compounded annually, what will be the present value of the \$100 two years from today?

- A) \$67.68
- B) \$68.30
- C) \$82.27

D) \$82.64

E) \$90.70

9

Your best friend gave you \$100 as a present six years ago. You invested this money at a 7 percent rate of interest. How much will this money be worth 10 years from today?

A) \$150.07

B) \$196.72

C) \$248.09

D) \$295.22

E) \$303.03

10

In a growing Midwestern town, the number of eating establishments at the end of each of the last five years are as follows: Year 1 = 143; Year 2 = 149; Year 3 = 162; Year 4 = 171; Year 5 = 178. If the number of eating establishments is expected to grow in year 6 at the same rate as the percentage increase in year 5, how many new eating establishments will be added in year 6?

A) 4

B) 6

C) 7

D) 9

E) 10

## Discounted Cash Flow Valuation

1

An annuity is a level stream of cash flows for a fixed period of time.

A) True

B) False

2

A perpetuity is the same thing as an annuity due.

A) True

B) False

3

The stated interest rate is the same thing as the effective annual rate.

A) True

B) False

4

An interest rate quoted as 6 percent compounded monthly means interest is paid at a rate of 6 percent each month.

A) True

**B) False**

5

Which of the following can be computed?

- I. present value of a perpetuity
- II. future value of a perpetuity
- III. present value of an annuity due
- IV. future value of an annuity due

- A) I and III only
- B) II and III only
- C) II, III, and IV only
- D) I, III, and IV only**
- E) I, II, III, and IV

6

You have won a prize which will pay you or your heirs \$25,000 a year for 50 years. The first payment is due immediately. What is the present value of this prize given an 8 percent discount rate?

- A) \$300,000
- B) \$305,837
- C) \$309,650
- D) \$312,500
- E) \$330,304**

7

Which of the following statements are true?

- I. There is an inverse relationship between present values and interest rates.
- II. The effective annual rate will be higher than the annual percentage rate for a loan that compounds interest monthly.
- III. There is an inverse relationship between future values and periods of time.
- IV. All else equal, the more frequently interest is compounded on a loan, the more interest you will have to pay.

- A) I and II only
- B) III and IV only
- C) II, III, and IV only
- D) I, II, and IV only**
- E) I, II, III, and IV

8

Suppose you invest \$10 for one year, and at the end of the year you receive back \$12. Which of the following statements must be true concerning your investment?

- I. The quoted rate must have been greater than 20 percent.
- II. To figure the quoted rate, you would need to know how often the investment was compounded.
- III. The effective annual rate was 20 percent.
- IV. The continuously compounded effective annual rate has to be 20 percent.

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- A) I and III only.
- B) II and III only**
- C) I and IV only
- D) II, III, and IV only
- E) I, II, and III only

9

Bernie just won a contest with a grand prize of \$250,000. The contest stipulates that the winner will receive \$100,000 immediately plus \$15,000 at the end of each of the next 10 years. If Bernie can earn 5 percent on his money, how much is this prize worth to him today?

- A) \$114,285.71
- B) \$166,175.62
- C) \$189,345.45
- D) \$215,826.02**
- E) \$250,000.00

10

You obtain a \$100,000, 30-year fixed-rate mortgage at 8.25 percent compounded monthly. Although you get a 30-year mortgage, you plan to prepay the loan by making an additional payment each month along with your regular payment. How much extra must you pay each month if you wish to pay off the loan in 20 years?

- A) \$24.56
- B) \$54.88
- C) \$100.80**

- D) \$103.28
- E) \$106.86

## Interest Rates and Bond Valuation

1

Considering the time period since the Great Depression, the real push to raise capital by issuing junk bonds really began in the late 1970s.

- A) True**
- B) False

2

The call premium typically starts at 10 percent of par and decreases to zero with the passage of time.

- A) True
- B) False**

3

A call provision, but not a sinking fund, allows a company to retire its debt early.

- A) True
- B) False**



4

An upward sloping yield curve reflects investors' desire for compensation for interest rate risk.

A) True

B) False

5

If you multiply a bond's current yield by its market price you get the:

A) yield to maturity.

B) investors' required rate of return.

C) annual coupon rate.

D) cost of capital.

E) annual coupon payment.

6

You want to own equity in a foreign oil company, but no shares of stock are currently being offered for sale. If there are \_\_\_\_\_ for sale, you could purchase these and then trade them in for shares of stock.

A) convertible bonds

B) put bonds

C) debentures

D) zero coupon bonds

E) subordinated debentures

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7

Which of the following bonds can be terminated prior to maturity by the issuer?

- I. callable bond
- II. bond with sinking fund provision
- III. convertible bond
- IV. put bond

- A) I and II only**
- B) II and III only
- C) III and IV only
- D) I, II, and IV only
- E) I, II, and III only

8

Which one of the following items does NOT generally appear in a Wall Street Journal corporate bond quote?

- A) estimated spread over a Treasury security
- B) market price
- C) yield-to-maturity**
- D) coupon rate
- E) maturity date

9

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Which of the following factors affect the term structure of interest rates?

- I. expected rate of inflation
- II. interest rate risk premium
- III. real rate of interest

- A) I only
- B) II only
- C) I and II only
- D) I and III only
- E) I, II, and III**

10

HomeSafe Cab Co. wants to issue new 10-year bonds to finance its expansion plans. Currently the company has 9 percent semiannual bonds selling for \$1,067.95 that mature 10 years from now. What must the coupon rate of the new bonds be in order for the issue to sell at par if interest is paid semiannually?

- A) 4.00 percent
- B) 4.21 percent
- C) 7.72 percent
- D) 7.99 percent
- E) 8.00 percent**

**Stock Valuation**

1

Most preferred stock has dividends that are cumulative.

A) True

B) False

2

For income tax purposes, preferred stock is more like debt than common stock.

A) True

B) False

3

If you use the constant growth model to value stock, you assume that  $P_1 = P_0 \times (1 + g)$ .

A) True

B) False

4

The effect of cumulative voting is to permit minority participation.

A) True

B) False

5

As illustrated using the dividend growth model, the total return on a share of common stock is comprised of a:

- A) capital gains yield and a dividend growth rate.
- B) capital gains growth rate and a dividend growth rate.
- C) dividend yield and a required rate of return.
- D) dividend yield and the expected price next year.
- E) dividend yield and a capital gains yield.**

6

Which one of the following terms is typically associated with both preferred stock and common stock?

- A) proxy
- B) voting rights
- C) dividend yield**
- D) arrearage
- E) cumulative voting

7

Which one of the following statements is true about the differences between debt and common stock?

- A) Debt is ownership in a firm but equity is not.
- B) Creditors have voting power while stockholders do not.

C) Periodic payments made to either class of security are tax deductible for the issuer.

- D) Interest payments are promised while dividend payments are not.
- E) Bondholders can also own equity, but shareholders can not own bonds.

8

A \_\_\_\_\_ is a NYSE member who is a dealer assigned as a market maker for a particular security.

- A) broker
- B) dealer
- C) member
- D) floor trader
- E) specialist

9

A \_\_\_\_\_ maintains an inventory and stands ready to buy and sell at any time.

I. dealer

II. specialist

III. broker

- A) I only
- B) III only
- C) I and II only
- D) I and III only

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E) II and III only

10

There is an election being held to fill two seats on the board of directors of a firm in which you hold stock. There is a total of 420 shares outstanding. If the election is conducted under cumulative voting and you own 120 shares, how many more shares must you buy to be assured of earning a seat on the board?

A) 0

B) 2

C) 21

D) 91

E) 141

### Net Present Value and Other Investment Criteria

1

A firm that only accepts projects for which the IRR is equal to the firm's required return will, on average, neither create nor destroy wealth for its shareholders.

A) True

B) False

2

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The profitability index is computed using accounting income and accounting book Values.

- A) True
- B) False**

3

An advantage of the payback rule is that it is easy to understand.

- A) True**
- B) False

4

For projects with conventional cash flows and positive discount rates, the payback period will be shorter than the discounted payback period.

- A) True**
- B) False

5

Which of the following consider the time value of money in their computation?

- I. payback
- II. average accounting return
- III. profitability index



- A) I only
- B) II only
- C) III only**
- D) I and III only
- E) II and III only

6

The average accounting return (AAR) decision rule states that a project should be accepted whenever the AAR:

- A) is positive.
- B) exceeds the internal rate of return (IRR).
- C) indicates that a project has more than recaptured its initial cost in terms of net income.
- D) exceeds the target AAR.**
- E) is less than the IRR.

7

Which of the following questions are addressed in the capital budgeting process?

- I. What products or services will we offer or sell?
- II. In what markets will we compete?
- III. What new products will we introduce?

- A) I only
- B) III only

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- C) I and II only
- D) I and III only
- E) I, II, and III**

8

Which one of the following factors can cause a project to have multiple IRRs?

- A) a large initial cash outlay
- B) an initial cash investment followed by positive cash flows for three years and a negative cash flow in the final year**
- C) negative cash flows in the first three years of a project but positive cash flows thereafter
- D) conventional cash flows
- E) mutually exclusive investments

9

You run a small bagel shop and are considering replacing your four sales clerks with automated machines that allow customers to buy their bagels without any human interaction. Of the following, the most difficult task you face in computing the net present value of this project is estimating the:

- A) proposed reduction in wages.
- B) tax shield of the new project.
- C) cost of the new equipment that will be required.
- D) cost of installing the new equipment.
- E) total change in sales.**

10

You are going to choose one of two mutually exclusive investments. Investment A pays \$35,000 a year for four years and has an initial cost of \$80,000. Investment B pays \$60,000 a year for five years and has an initial cost of \$170,000. If your required return is 13 percent, which investment should you choose and why?

- A) A; because it costs less initially
- B) A; because its IRR exceeds 13 percent
- C) A; because it has a higher IRR
- D) B; because its IRR exceeds 13 percent
- E) B; because it has a higher NPV**

### Making Capital Investment Decisions

1

To accurately reflect the costs associated with a project, you should exclude interest expenses in the computation of the operating cash flows.

- A) True**
- B) False

2

Side effects such as erosion should be considered in a capital budgeting decision.



A) True

B) False

3

The idea behind setting a bid price is to determine the minimum price at which the net present value of a project will still be zero or positive.

A) True

B) False

4

An opportunity cost is the most valuable alternative that is given up if a particular investment is undertaken.

A) True

B) False

5

A taxable gain occurs when an asset is sold for more than its book value. For capital budgeting purposes, the taxes on the sale are treated as a:

A) reduction in cash and added to operating cash flow.

B) noncash event similar to depreciation.

C) reduction in cash and deducted from the book value of the asset.

D) reduction in cash and deducted from the taxable gain.

E) reduction in cash and deducted from the sale price.

6

Pro forma statements:

- A) are generally created by first estimating production costs.
- B) for a proposed project generally consider only the first year of the project.
- C) recap a firm's activities for the past year.
- D) should only be prepared when considering a capital budgeting project.
- E) should use realistic assumptions.**

7

You are advising a friend who is attempting to decide whether or not to drop one of the courses they are currently enrolled in. If they do, they will forfeit half of the money spent on tuition. Which of the following conclusions drawn by your friend is consistent with capital budgeting principles?

- I. Remaining in the class incurs opportunity cost because they have to reduce the number of hours they are gainfully employed.
- II. The tuition is irrelevant to the decision because it is a sunk cost.
- III. The time and energy put into the course thus far is a sunk cost.

- A) I only
- B) I and II only
- C) I and III only**
- D) II and III only
- E) I, II, and III

8

A firm moves into a higher tax bracket. All else equal, the depreciation tax shield will:

- A) be more valuable.
- B) be less valuable.
- C) remain unchanged since depreciation doesn't change.
- D) remain unchanged because changes in tax rates don't matter once a project is in place.
- E) be either more valuable, less valuable, or unchanged, but it is impossible to tell which without more information.

9

Your company may introduce a new line of tennis shoes. You have been given the following projections: sales = 35,000 units at \$40 per unit; variable costs = \$25 per unit; fixed costs = \$125,000 per year; initial investment = \$1,000,000; project life = 10 years. What is the net income for this project if the corporate tax rate is 34 percent? You may assume straight-line depreciation to a zero book value and a discount rate of 12 percent.

- A) \$119,000
- B) \$165,000
- C) \$198,000
- D) \$264,000
- E) \$297,000

10

You are considering investing in a cost cutting proposal. Net income from the project is expected to equal \$27.50 each of the three years of the project's life. The process has an initial cost of \$125 and will be depreciated straight-line over 3 years

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to a salvage value of \$0. Assume a 34 percent tax bracket and a discount rate of 15 percent. Suppose the equipment is sold at the end of year 3 for \$20, pretax. What is the internal rate of return?

- A) 16.3 percent
- B) 29.5 percent
- C) 33.6 percent**
- D) 45.8 percent
- E) 62.7 percent

## Project Analysis and Evaluation

1

The degree of operating leverage is equal to the percentage change in the operating cash flow divided by the percentage change in sales quantity.

- A) True**
- B) False

2

A project that just breaks even on a cash basis must have a zero net present value.

- A) True
- B) False**

3

A project that just breaks even on an accounting basis has a discounted payback period equal to its life.

- A) True
- B) False**

4

If a division of a firm finds an exceptionally worthwhile positive net present value project they still will not be able to obtain funding if they are under hard rationing.

- A) True**
- B) False

5

Which of the following statements are true concerning scenario analysis?

- I. A positive net present value for a project's worst case scenario guarantees you a positive return from the project.
- II. The base case scenario generally represents an average estimate of the net present value.
- III. If the net present value of the best case scenario is negative then it is probably unnecessary to create base and worst case scenarios.
- IV. Scenario analysis is less apt than sensitivity analysis to determine which variable has the greatest impact on the projected net present value.

- A) I and II only
- B) II and IV only





- C) III and IV only
- D) I, II, and III only
- E) II, III, and IV only**

6

Any time a manager replaces a variable cost with a fixed cost, the firm's \_\_\_\_\_ effectively increases.

- A) operating leverage**
- B) managerial options
- C) projected cash flow
- D) sensitivity contribution
- E) total variable cost

7

Which of the following describe(s) variable costs?

- I. costs that can be forecasted with a high degree of accuracy
- II. costs that are equal to zero when production is zero
- III. costs that change with the quantity of output

- A) II only
- B) I and II only
- C) I and III only
- D) II and III only**
- E) I, II, and III only

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8

Which of the following requires finding the point at which the net present value of a project is equal to zero?

- I. finding the project's internal rate of return
- II. finding the point at which the internal rate of return is equal to zero
- III. finding the point at which the project pays back on a discounted basis
- IV. finding the financial break-even point

- A) I and III only
- B) II and IV only
- C) I, II, and III only
- D) I, III, and IV only**
- E) I, II, III, and IV

9

Which of the following is (are) true about a project that just breaks even on an accounting basis?

- I. The project has an internal rate of return that is equal to zero.
- II. The project has an internal rate of return that is equal to 100 percent.
- III. The project has a negative net present value.
- IV. The project has a zero net present value.

- A) I and III only**

- B) I and IV only
- C) II and III only
- D) II and IV only
- E) IV only

10

Which of the following is (are) true about a project that breaks even on a financial basis?

- I. The project has a zero internal rate of return.
- II. The project has a negative net present value.
- III. The project has a zero net present value.
- IV. The project has an internal rate of return equal to the firm's required return.

- A) I only
- B) III only
- C) II and IV only
- D) I and III only
- E) III and IV only**

**Some Lessons from Capital Market History**

Capital market efficiency is attributable largely to the lack of competition among market participants for information.

- A) True
- B) False**

2

Investors should not count capital gains as part of total returns until the security is sold since the capital gain is really only a paper gain up to that point.

- A) True
- B) False**

3

Your classmate just made \$10,000 in a single day by trading in the stock market. It is reasonable to conclude, therefore, that the efficient market hypothesis cannot be true.

- A) True
- B) False**

4

In general, there is a reward for bearing risk.

- A) True**
- B) False

5

The normal distribution is so useful in analyzing security returns because:

- A) we frequently deal with finite data sets.
- B) of its bell-shaped appearance.
- C) 95 percent of all observations fall within two standard deviations of the mean.
- D) the distribution of security returns varies so much from a normal distribution.
- E) it can be completely described by its mean and standard deviation.**

6

Which one of the following investments was the least risky over the period 1926-2003?

- A) small-company stocks
- B) large-company stocks
- C) U.S. Treasury bills**
- D) long-term government bonds
- E) long-term corporate bonds

7

Which one of the following statements is accurate regarding market efficiency?

- A) In an efficient market, prices adjust quickly and correctly to new information.**
- B) Asset prices in an efficient market are usually too high or too low.

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C) When stock prices move in an overreaction and correction pattern as a result of the release of new information, the market for this stock is efficient.

D) A market is weak form efficient if all information of every kind is reflected in the stock prices.

E) You cannot make money by trading on inside information in a market that is semistrong form efficient.

8

Over the 1926-2003 period, the standard deviation of the returns on long-term corporate bonds has averaged \_\_\_\_\_ percent per year.

A) 3.1

**B) 8.6**

C) 9.4

D) 20.4

E) 33.3

9

Over the last three years you earned 5 percent, 7 percent, and 9 percent. What is the standard deviation of your returns?

A) 0.8 percent

B) 1.6 percent

**C) 2.0 percent**

D) 2.3 percent

E) 2.9 percent

10

Compute the incremental reward for bearing the risk of owning small-company stocks rather than large-company stocks given the following average returns from 1926-2003: large-company stocks = 12.4 percent, small-company stocks = 17.5 percent, long-term government bonds = 5.8 percent, and U.S. Treasury bills = 3.8 percent.

- A) 1.3 percent
- B) 1.9 percent
- C) 5.1 percent**
- D) 8.6 percent
- E) 13.7 percent

### Return, Risk, and the Security Market Line

1

A unique risk is a risk that affects a relatively large number of the assets in the market.

- A) True
- B) False**

2

Both the variance and the standard deviation are expressed in percentage terms.

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A) True

**B) False**

3

The projected risk premium is defined as the sum of the expected return on a risky investment and the return on a risk-free investment.

A) True

**B) False**

4

An example of systematic risk would be an unexpected change in interest rates by the Federal Reserve.

**A) True**

B) False

5

Which one of the following statements is true regarding the beta coefficient?

A) Beta is a measure of unsystematic risk.

B) A beta greater than one represents less systematic risk than the market.

**C) Generally speaking, the higher the beta the higher the expected return.**

D) A beta of one indicates an asset is totally risk-free.



E) The risk premium of an asset will increase if the beta of that asset decreases.

6

Given the following notation, what is the equation for the security market line?

$E(R_i)$  = expected return on risky asset i

$R_m$  = return on the market portfolio

$E(R_m)$  = expected return on the market portfolio

$\beta_i$  = risky asset i's beta

$\beta_m$  = market portfolio's beta

$R_f$  = risk-free rate of return

A)  $E(R_i) = R_m + [E(R_m) - R_f] \times \beta_m$

B)  $E(R_m) = R_f + [E(R_m) - R_f] \times \beta_i$

C)  $E(R_i) = R_m + [E(R_m) - R_f] \times \beta_i$

D)  $E(R_i) = R_f + [E(R_m) - R_f] \times \beta_m$

**E)  $E(R_i) = R_f + [E(R_m) - R_f] \times \beta_i$**

7

Which of the following have been eliminated from a well-diversified portfolio?

I. market risk

II. asset specific risk

III. unsystematic risk

IV. systematic risk

- A) I only
- B) II only
- C) I and IV only
- D) II and III only**
- E) I, II and III only

8

Which of the following pairs of terms are synonymous?

- I. systematic risk and unique risk
- II. market risk and systematic risk
- III. unsystematic risk and asset-specific risk

- A) I only
- B) II only
- C) III only
- D) II and III only**
- E) I, II, and III

9

What is the risk premium on the following stock if the risk-free rate is 5 percent? The boom state has a probability of occurring of 15 percent and an expected return of 60 percent; the good state has a 50 percent chance of occurring and an expected return of 20 percent; the recession state has a 25 percent chance of occurring and an expected loss of 10 percent; and the depression state has a 10 percent chance of occurring and an expected loss of 30 percent.

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A) 0.085

B) 0.100

C) 0.125

D) 0.135

E) 0.175

10

Security X has a standard deviation of returns of 35 percent and a beta of 1.45.  
Security Y has a standard deviation of returns of 28 percent and a beta of 1.06.  
Security Z has a standard deviation of returns of 44 percent and a beta of 1.22.

Given this, which one of the following statements is correct?

A) Security Z has the greatest total risk because it has the largest standard deviation.

B) Security X has the greatest total risk because it has the largest beta.

C) Security X has the greatest diversifiable risk because it has the largest beta.

D) Security Y has the lowest total risk because it has the lowest beta.

E) An equally weighted portfolio of the three will have the same systematic risk as the market portfolio.

Options and Corporate Finance

1

Warrants are usually issued as sweeteners with public bond issues.

A) True

**B) False**

2

The higher the exercise price, the greater the value of a call option, all else equal.

A) True

**B) False**

3

A call option can be worth more than its underlying asset.

A) True

**B) False**

4

The value of a call option is equal to the stock price minus the present value of the exercise price.

**A) True**

B) False

5

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All else equal, which of the following statements is (are) true for a firm with positive earnings?

- I. Earnings per share will increase when bonds are converted into shares of common stock.
- II. Earnings per share decrease when warrants are exercised.
- III. Fully diluted earnings per share will be less than the undiluted earnings per share if either convertible bonds or warrants are involved.
- IV. Exercising a warrant decreases the number of shares of common stock outstanding.

- A) I and III only
- B) II and IV only
- C) I and IV only
- D) II and III only**
- E) I and II only

6

Which one of the following statements is true?

- A) The lower the underlying share price, the higher the value of a call option.
- B) The lower the exercise price, the lower the value of a call option.
- C) The longer the time to expiration, the lower the value of a call option.
- D) The greater the interest rate, the lower the value of a call option.
- E) The lower the risk of the underlying security, the lower the value of a call option.**

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7

The bonds of DEF are convertible into shares of the firm's common stock at \$50 per share. The current price of the common stock is \$45 per share. The bonds have a \$1,000 par value and currently sell for \$950 apiece. What is the conversion ratio of these bonds?

A) 20

B) 22

C) 25

D) 45

E) 50

8

What is the time value per share of the March put?

A) \$0.00

B) \$1.00

C) \$1.50

D) \$2.00

E) \$4.00

9

What is the conversion ratio for this bond?

A) 9.8

B) 12.3

C) 15.4

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- D) 16.7
- E) 22.2

10

What is the minimum value of this bond if the current stock price is \$69.50 a share and the conversion ratio used is 15.4?

- A) \$778.43
- B) \$867.39
- C) \$939.00
- D) \$1,034.32
- E) \$1,070.30**

## Cost of Capital

1

For a profitable firm, an increase in its marginal tax rate will increase its weighted average cost of capital if the firm has debt in its capital structure.

- A) True
- B) False**

2

For the purpose of estimating the firm's cost of capital, one cannot look only at the coupon rate on the firm's existing debt.



A) True

B) False

3

The return on equity is the return that equity investors require on their investment in the firm.

A) True

B) False

4

One method of computing a divisional cost of capital is to use the pure-play approach.

A) True

B) False

5

All else equal, a higher corporate tax rate will:

A) increase the WACC of a firm with debt and equity in its capital structure.

B) decrease the WACC of a firm with debt in its capital structure.

C) not affect the WACC of a firm with debt in its capital structure.

D) decrease the WACC of a firm with only equity in its capital structure.

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E) change the WACC of a firm with debt in its capital structure, but the direction of the change cannot be determined without more information.

6

Which one of the following is a disadvantage of the dividend growth model presented in the text for estimating the cost of equity?

A) The dividend growth model only applies to firms whose dividend growth rate fluctuates widely.

B) The dividend growth model only applies to companies that are not currently paying any dividends.

C) The dividend growth model explicitly considers risk.

**D) The estimated cost of equity computed using the dividend growth model is highly sensitive to the estimated growth rate.**

E) Historical dividends can be used as a basis for future dividends unless the firm has undergone a major change or revised its dividend policy.

7

Ignoring taxes, if a firm issues debt at par, then the cost of debt:

I. is equal to its coupon rate.

II. is equal to its yield-to-maturity.

III. differs from its current yield.

A) I only

**B) I and II only**

C) II only

D) I and III only

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- E) I, II, and III

8

A project has the same risk as the firm's overall operations and must be financed externally. Equity costs 15 percent and debt costs 4 percent after-tax. The firm's debt/equity ratio is .8. The tax rate is 34 percent. What is the minimal internal rate of return the project must earn to be accepted?

- A) 51 percent  
B) 10.1 percent  
C) 6 percent  
D) 2 percent  
E) 5 percent

9

Hartley Psychiatric, Inc. needs to purchase office equipment for its 2,000 drive-in therapy centers nationwide. The total cost of the equipment is \$2 million. It is estimated that the after-tax cash inflows from the project will be \$210,000 annually forever. Hartley has a debt-to-value ratio of 40 percent based on market values. The firm's cost of equity is 13 percent and its pre-tax cost of debt is 8 percent. The flotation costs of debt and equity are 2 percent and 8 percent, respectively. Assume the firm's tax rate is 35 percent. Ignoring flotation costs, what is the NPV of the proposed project?

- A) \$33,966  
B) \$65,990  
C) \$98,542  
D) \$125,506  
E) \$128,034

10

Hartley Psychiatric, Inc. needs to purchase office equipment for its 2000 drive-in therapy centers nationwide. The total cost of the equipment is \$2 million. It is estimated that the after-tax cash inflows from the project will be \$210,000 annually forever. Hartley has a debt-to-value ratio of 40 percent based on market values. The firm's cost of equity is 13 percent and its pre-tax cost of debt is 8 percent. The flotation costs of debt and equity are 2 percent and 8 percent, respectively. Assume the firm's tax rate is 35 percent. After considering flotation costs, what is the NPV of the proposed project?

- A) -\$72,957
- B) \$428
- C) \$2,091
- D) \$6,862**
- E) \$178,675

### Raising Capital

1

Large rights offerings are more common in industrialized nations other than the United States.

- A) True**
- B) False

2

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According to the textbook, the market value of a firm's outstanding shares will most likely fall upon the announcement of a new equity offering.

A) True

B) False

3

Empirical evidence suggests that, on average, the shares in initial public offerings have not been significantly underpriced.

A) True

B) False

4

Central Maine Power Company, a regional electric utility, sells 500,000 shares of common stock to investors at large. This is most likely to be a best efforts offering.

A) True

B) False

5

The option giving the underwriter the ability to purchase additional shares of stock at the offer price is called:

A) a shelf registration.

B) a Green Shoe provision.

C) dilution.



- D) standby underwriting.
- E) a firm commitment offering.

6

Which one of the following parties will probably benefit the most from the overpricing of a new IPO of common stock handled on a firm-commitment basis?

- A) existing bondholders
- B) the underwriter
- C) new shareholders who purchase stock in the open market during the aftermarket
- D) the issuing firm**
- E) new shareholders who purchase stock from the syndicate

7

If the underwriter wishes to have the option to make additional profits if an IPO is oversubscribed, they may ask that the underwriting contract contain a:

- A) protective covenant.
- B) tombstone clause.
- C) preemptive right provision.
- D) Regulation A provision.
- E) Green Shoe provision.**

8

According to the figures in the text, on average, IPOs:

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- A) are brought to the market in waves.
- B) are overpriced.
- C) have the same flotation costs as seasoned issues.
- D) produce negative first-day returns.
- E) are a profitable investment and you should buy shares in any IPO that hits the market.

9

Which of the following is (are) correct regarding flotation costs?

- I. On average, there are substantial economies of scale in issuing securities.
- II. The costs of issuing debt securities are greater than the costs of issuing equity securities.
- III. On average, it costs more to float a seasoned offering than an IPO.
- IV. Convertible bonds are cheaper to issue than straight bonds.

- A) I only
- B) IV only
- C) I and IV only
- D) I, II, and IV only
- E) II and III only

10

Unique Auto Parts, Inc., a manufacturer of reproduction parts for classic automobiles, needs to raise \$2 million via a rights offering. The subscription price is \$4 per share. The firm currently has 1,000,000 shares outstanding with a current market price per share of \$5. What will the value of a right be?

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- A) \$.25
- B) \$.33**
- C) \$.40
- D) \$.50
- E) \$1.20

## Financial Leverage and Capital Structure Policy

1

If the static theory of capital structure is true, then the optimal level of debt for a given firm increases as its marginal tax rate increases and decreases as the costs of financial distress increase.

- A) True**
- B) False

2

Direct bankruptcy costs are those costs that are directly associated with bankruptcy, such as legal and administrative expenses.

- A) True**
- B) False

3

Business risk is a positive function of the systematic risk of a firm's assets.

A) True

B) False

4

Because investors can use homemade leverage to create any level of financial leverage they desire, the capital structure of a firm does not matter to them.

A) True

B) False

5

All else equal, the financial leverage of a firm will:

A) decrease as the amount of debt increases relative to equity.

B) decrease as the firm's retained earnings account grows.

C) increase by the amount of equity it issues in a given year.

D) decrease if the firm has negative net income.

E) decrease as the firm uses debt to fund expansion projects.

6

Which of the following is (are) true regarding observed capital structures?

I. Drug companies appear to use less debt than electric utility companies do.

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II. It appears that many firms choose to pay substantial taxes rather than increase debt to further benefit from the interest tax shield.

III. It appears that, for whatever reason, capital structures vary quite a bit across industry groups.

- A) I only
- B) III only
- C) I and III only
- D) I and II only
- E) I, II, and III**

7

Which of the following statements concerning leverage are correct?

I. Shareholders can offset the financial leverage of a firm through the use of homemade leverage.

II. The effect of financial leverage depends on a company's earnings before interest and taxes.

III. The use of leverage by a firm does not affect the earnings per share.

IV. Homemade leverage involves the use of personal borrowing or personal lending.

- A) I and III only
- B) II and IV only
- C) I, III, and IV only
- D) I, II, and IV only**
- E) I, II, III, and IV

8

A firm with no debt has 200,000 shares outstanding valued at \$20 each. Its cost of equity is 12 percent. The firm is considering adding \$1,000,000 in debt to its capital structure. The coupon rate would be 8 percent and the firm's tax rate is 34 percent. What would the firm be worth after adding the debt?

- A) \$4.033 million
- B) \$4.180 million
- C) \$4.340 million**
- D) \$4.660 million
- E) \$5.000 million

9

A firm has an unlevered cost of capital of 10 percent, a cost of debt of 9 percent, and a tax rate of 34 percent. If it desires a cost of equity of 14 percent, what must its target debt/equity ratio be?

- A) 2.49
- B) 3.89
- C) 4.68
- D) 5.14
- E) 6.06**

10

Given the following information, what is GEM Corporation's WACC? EBIT = \$2 million; tax rate = 34 percent; market value and book value of debt = \$4 million; unlevered cost of capital = 14 percent; cost of debt = 9 percent.

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- A) 11.4 percent
- B) 11.9 percent
- C) 12.2 percent**
- D) 12.6 percent
- E) 13.1 percent

## Dividends and Dividend Policy

1

If stock issuance costs are high, investors will prefer low-dividend stocks to high-dividend stocks, all else equal.

- A) True**
- B) False

2

Once it is declared, a common stock dividend becomes a legal financial obligation of the firm.

- A) True**
- B) False

3

Suppose a firm wishes to pay cash to its shareholders. The only way to do so is to pay a dividend.

- A) True
- B) False**

4

A reverse split is a stock split in which a firm's number of shares outstanding is reduced.

- A) True**
- B) False

5

All else equal, which of the following are correct concerning stock splits and stock dividends? All of the statements refer to book values, not market values.

- I. The par value of the stock will change only with the stock split.
- II. Total owners' equity will not change with either a stock split or a stock dividend.
- III. The primary effect of either is to increase the number of shares outstanding.
- IV. Earnings per share will likely decrease only with the stock dividend.

- A) I and III only
- B) II and IV only
- C) I and II only

**D) I, II and III only**

E) I, II, III and IV

6

Which of the following are accurate regarding share repurchases?

I. In a world without imperfections, there is essentially no difference between a share repurchase and a cash dividend.

II. Share repurchases cannot be undertaken for the sole purpose of avoiding taxes.

III. Repurchasing shares is a useful method of stabilizing cash dividends.

IV. Share repurchases result in an increase in earnings per share.

A) IV only

B) I and III only

C) II and IV only

D) I, II, and IV only

**E) I, II, III, and IV**

7

Which of the following are consistent with the existence of an information content effect of dividends?

I. IBM's share price rises upon the announcement of unexpectedly high earnings and a larger than expected increase in its current quarterly dividend.

II. GM's share price falls on the same day the firm announces a stock dividend.

III. Con Ed's share price drops by 33 percent after it announces it is omitting its regular quarterly dividend payment.

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- A) I only
- B) II only
- C) III only
- D) I and II only
- E) I and III only**

8

Stansfield, Inc. currently has 400,000 shares of stock outstanding, each with a market price of \$20 and a par value of \$2. The firm would prefer to have its stock trade at a value of between \$30 and \$35 per share. Of the following choices, which one would allow the firm to achieve its objective?

- A) 2-for-1 stock split
- B) 50 percent stock dividend
- C) 2-for-3 reverse stock split**
- D) 1-for-2 reverse stock split
- E) \$2 per share cash dividend

9

Sesame Sweet, Inc. has 220,000 shares outstanding with a par value of \$1 per share and a market price of \$12.00 per share. Capital in excess of par amounts to \$540,000, while retained earnings is \$275,000. There is no treasury stock and there are no transactions costs. Suppose Sesame Sweet declares a 10 percent (small) stock dividend. What happens to total owners' equity on the balance sheet?

- A) It remains unchanged.**
- B) The account increases by \$22,000.

- C) The account increases by \$44,000.
- D) The account increases by \$242,000.
- E) The account increases by \$264,000.

10

Sesame Sweet, Inc. has 220,000 shares outstanding with a par value of \$1 per share and a market price of \$12.00 per share. Capital in excess of par amounts to \$540,000, while retained earnings is \$275,000. There is no treasury stock and there are no transactions costs. Suppose Sesame Sweet declares a 3-for-1 stock split. What is the market price of a share of the company's stock after the split?

- A) \$4.00 per share**
- B) \$5.75 per share
- C) \$6.00 per share
- D) \$8.00 per share
- E) \$36.00 per share

## Short-Term Finance and Planning

1

A firm is not considered healthy unless its accounts payable period exceeds its operating cycle.

- A) True